This is a digital copy of a book that was preserved for generations on library shelves before it was carefully scanned by Google as part of a project to make the world's books discoverable online.

It has survived long enough for the copyright to expire and the book to enter the public domain. A public domain book is one that was never subject to copyright or whose legal copyright term has expired. Whether a book is in the public domain may vary country to country. Public domain books are our gateways to the past, representing a wealth of history, culture and knowledge that's often difficult to discover.

Marks, notations and other marginalia present in the original volume will appear in this file - a reminder of this book's long journey from the publisher to a library and finally to you.

Usage guidelines

Google is proud to partner with libraries to digitize public domain materials and make them widely accessible. Public domain books belong to the public and we are merely their custodians. Nevertheless, this work is expensive, so in order to keep providing this resource, we have taken steps to prevent abuse by commercial parties, including placing technical restrictions on automated querying.

We also ask that you:

+ *Make non-commercial use of the files* We designed Google Book Search for use by individuals, and we request that you use these files for personal, non-commercial purposes.

+ *Refrain from automated querying* Do not send automated queries of any sort to Google's system: If you are conducting research on machine translation, optical character recognition or other areas where access to a large amount of text is helpful, please contact us. We encourage the use of public domain materials for these purposes and may be able to help.

+ *Maintain attribution* The Google "watermark" you see on each file is essential for informing people about this project and helping them find additional materials through Google Book Search. Please do not remove it.

+ *Keep it legal* Whatever your use, remember that you are responsible for ensuring that what you are doing is legal. Do not assume that just because we believe a book is in the public domain for users in the United States, that the work is also in the public domain for users in other countries. Whether a book is still in copyright varies from country to country, and we can't offer guidance on whether any specific use of any specific book is allowed. Please do not assume that a book's appearance in Google Book Search means it can be used in any manner anywhere in the world. Copyright infringement liability can be quite severe.

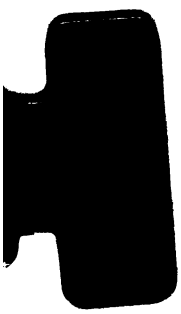
About Google Book Search

Google's mission is to organize the world's information and to make it universally accessible and useful. Google Book Search helps readers discover the world's books while helping authors and publishers reach new audiences. You can search through the full text of this book on the web at `http://books.google.com/`

TX
W178c
Storage
US 973.1 WAL
Unconstitutional character & the ll
HARVARD LAW LIBRARY AQF9821
3 2044 032 068 900
S

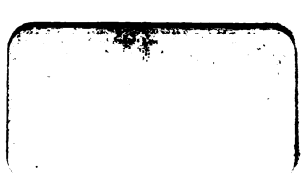
.50

Bd Apr 1914



HARVARD LAW LIBRARY

Received Mar. 9. 1914

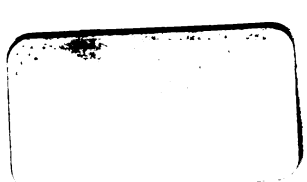


.50

Bd Apr 1914

HARVARD LAW LIBRARY

Received Mar. 9. 1914



THE UNCONSTITUTIONAL CHARACTER

AND

THE ILLEGAL ADMINISTRATION

OF

THE INCOME TAX LAW

DEMONSTRATED

BY

ALBERT H. WALKER

AUTHOR OF

WALKER ON PATENTS,

AND THE

HISTORY OF THE SHERMAN LAW.

PUBLISHED AT THE LAW OFFICES
OF THE AUTHOR:
Floor 10, PARK ROW BUILDING,
NEW YORK CITY.

THE PRICE IS A DOLLAR

COPYRIGHT, 1914
BY
ALBERT H. WALKER

PREFACE.

My first pamphlet on the income tax law was published in October, 1913, and has gone into extensive use throughout the United States. Its character is indicated by its title "The Income Tax Law, of the United States of America, Analyzed and Clarified." It contains no detailed criticism of the statute, except in incidentally specifying a few of its errors and ambiguities, without elaborating upon any of them. When it was published, the administration of the statute had not begun, and therefore could not be made a subject of discussion. During the fifteen weeks which have passed since then, no error of translation has been made known to me as occurring in that pamphlet; and it will probably always be regarded as being, what it purports to be.

This second pamphlet has resulted from the application to the provisions of the statute, of the relevant provisions of the Constitution of the United States; and from the application to the administration of the statute, of the provisions of the statute itself, and of some of those principles of ethics and equity, which all good men regard as a proper system of moral law. The writing of every unquoted sentence in this pamphlet, was done with the utmost care to state with accuracy, everything stated therein; and with a constant sense of responsibility to the public, and to "that infinite and eternal energy, from which all things proceed."

ALBERT H. WALKER.

Park Row Building,
Manhattan, New York,
February 4, 1914.

TX
W178c

MAR 9 1914

TABLE OF CONTENTS.

PART ONE.

	PAGES
CRITICISMS	1-27
Chapter I. Unconstitutional	1-10
Section A. Confiscatory	1-7
Section B. Retroactive	7-10
Chapter II. History	11-16
Chapter III. Character	16-22
Chapter IV. Administration	22-27

PART TWO.

INCOME TAX RETURNS	28-84
Introduction	28-31
Section 1. Relevant to Natural Persons	31-49
Section 2. Relevant to Fiduciaries	50-57
Section 3. Relevant to Corporations	58-84

PART THREE.

RECOMMENDED REMEDIES	85-89

PART ONE.

CRITICISMS

CHAPTER I.

UNCONSTITUTIONAL.

SECTION A.

CONFISCATORY.

All the provisions of the statute of 1913, "relating to the deduction and payment of the tax at the sources of income" are void; because they are contrary to the Fifth Amendment to the Constitution of the United States. That amendment prohibits the enactment by Congress of any statute, which, if enforced, will deprive any person or corporation of property without due process of law. Thirty-seven years ago that great judge in constitutional law, Mr. Justice Miller, when delivering the opinion of the Supreme Court of the United States in the case of Davidson *v.* New Orleans (96 U. S. Reports, p. 99, 1877) explained that the phrase "due process of law" in the Federal Constitution, is not to be defined by a single statement, but that its meaning is to be arrived at "by the gradual process of judicial inclusion and exclusion, as the cases presented for decision shall require, with the reasoning on which such decisions may be founded." That gradual process of inclusion and exclusion has been

going on ever since, and will continue further into the future than we can foresee, before it becomes complete. But that process has already excluded many classes of transactions from the domain of "due process of law;" and among these, is every transaction which constitutes legislative confiscation of private property.

Now it is quite undeniable, among those who really understand the income tax law of October 3, 1913, that those of its provisions which relate to the deduction and payment of income taxes at their sources, are confiscatory provisions.

They are confiscatory, as against the persons whose incomes are thus taxed, because they purport to deprive those persons, at least temporarily, of much more money than the amount of the income tax imposed upon them by the statute. The particular part of the statute which must always have this effect, is composed of twenty-three words in subsection E, followed by the latter half of the first proviso of that subsection. When those two passages are properly joined together, they will be found to read as follows:

"In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source," that person shall not "be allowed the benefit of any deduction provided for in subsection B of this section, unless he shall, not less than thirty days prior to the day on which the return of his income is due, either file with the person who is required to withhold and pay the tax for him, a true and correct return of his annual gains, profits and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the per-

son required to withhold and pay the tax, or likewise make application for deductions, to the collector of the district in which return is made or is to be made for him."

On referring back to subsection B, it will be found that the deductions provided for thereby may belong to any or all of seven regularly numbered classes, and it is quite undeniable that many a person whose income tax is withheld and deducted, and paid or to be paid at the source, in pursuance of the provisions last quoted from subsection E of the statute, is entitled to deductions enough, under subsection B, of the statute, to relieve him from paying any income tax whatever, under the statute as a whole. But the statute as a whole, instead of providing any plan by means of which any such person can secure such relief, does provide that considerable money shall be withheld from him, by his employer or employers, or debtor or debtors and paid over to the Government, instead of being paid to him. And the statute provides that the person thus deprived of his money, without his consent and without his fault, and without being taxable, shall never get any of that money back again; unless he shall, not less than thirty days prior to March 1, either file with the person who has withheld his money from him, a true and correct return of his annual gains, profits and income from all other sources, and also the deductions asked for by him, or likewise present the same set of papers to the collector of the district in which return is made or is to be made for him.

This program presents a case of temporary confiscation of private property at least; and the statute provides that this confiscation shall become a permanent one, in every case where the victim does not learn and understand the statute soon enough to prepare and file,

at least thirty days prior to March 1, a certain set of papers disclosing his private affairs and praying to be permitted to escape from that confiscation.

And even if the victim does thus learn and understand the statute, and does prepare and file that set of papers, either with his employer or employers, or his debtor or debtors, or with the Collector of Internal Revenue of the district in which the return is made, or is to be made for him; the statute does not provide any certain way by means of which he can recover his confiscated property. Indeed, he can never recover that money, except by means of a petition presented by him to the Commissioner of Internal Revenue, in pursuance of Section 3220 of the Revised Statutes of the United States; followed, in not less than six months after its presentation, nor more than two years after the money was taken, by a suit in some court, against the particular collector of internal revenue, who collected the money. This program is provided for in Sections 3226 and 3227, of the Revised Statutes of the United States, as those sections were understood in 1895, by Mr. Justice White, when he delivered his dissenting opinion in the Pollock case, in 157 United States Reports at page 609.

Moreover, even if after a delay which may continue for years, the Commissioner of Internal Revenue does have to pay back to a particular victim, the money withheld from him long before, that victim will have been deprived of the use of that money during all that while. And the Fifth Amendment to the Constitution of the United States is violated as really, though not as extensively, when a person is deprived of property for a limited time, as when he is deprived of property forever.

Those provisions of the statute, which relate to the deduction and payment of income taxes at their sources, are also confiscatory, as against the vicarious persons and corporations which are required by the statute to act as agents of the Government in the business of collecting income taxes claimed by the Government to be due from the employee or creditors of those vicarious parties. As to them, the program of the statute is a process of garnishment. And that process, instead of being conducted as a judicial proceeding, as all such processes must be, in order to be valid, is conducted and controlled entirely by executive officers. And that process, instead of being conducted at the expense of the debtor or of the garnishor, as it should be, is conducted entirely at the expense of the garnishee. And that expense, in the case of each of many persons, or corporations having many employees or many creditors, or both, must amount to large sums of money. Now it is plain enough and quite undeniable, that a statute which compels any person or corporation to expend money, belonging to that person, or to the stockholders of that corporation, in the business of collecting taxes for the Government, from other persons or corporations, thereby confiscates all the money thus compelled by legislative enactment to be expended.

Those provisions of the income tax statute which relate to "the deduction and payment of the tax at the sources of income", being thus undeniably confiscatory, and therefore unconstitutional; they operate to invalidate the entire income tax Section II, of the tax statute of October 3, 1913; because that Section constitutes one entire scheme of taxation, which cannot survive the destruction of a part so pivotal.

The doctrine that an entire statute may be vitiated or rendered inoperative by the invalidity or inoperativeness of some, but not all, of its provisions, was the ground upon which the United States Supreme Court, in the case of Pollock *v.* Farmers' Loan & Trust Co., (158 U. S. 601, 1895) decided that the entire income tax law of 1894, was void. That income tax statute consisted of Sections 27 to 37, inclusive, of the United States tax statute, which became law in August, 1894, without the approval of President Cleveland; the bill therefor not having been either signed or vetoed by him, within ten days after he received it, and Congress having remained in session during those ten days. That income tax statute levied an annual tax upon property, rents, interest, dividends, and salaries, and also all income received from any profession, trade, employment or vocation carried on in the United States or elsewhere, by any of our citizens or residents. The Supreme Court decided that the Constitution of the United States did not authorize Congress to levy a tax upon any income from *property;* and that the fact that the income tax statute of 1894, included income from property, together with income from all other sources, rendered the statute invalid as to all income. The conclusions which Chief Justice Fuller formulated, to express exactly what points the Court decided, were formulated by him in the following three paragraphs:

"We adhere to the opinion already announced, that, taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes."

"We are of opinion that taxes on personal property, or on the income of personal property, are likewise direct taxes."

"The tax imposed by sections twenty-seven to thirty-seven, inclusive, of the act of 1894, so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the Constitution, and, therefore, unconstitutional and void because not apportioned according to representation, all those sections, constituting one entire scheme of taxation, are necessarily invalid."

Section B.

Retroactive.

Even if the income tax statute of October, 1913, had not contained any provision for collecting income taxes at their "sources"; that statute would be inoperative, in respect of the whole of the year 1913; and nobody would be constitutionally and legally bound to pay any income tax for any portion of that year. This statement may startle at first, but it must convince at last. In the last analysis it will be seen to result from the following facts and considerations.

The Sixteenth Amendment to the Constitution of the United States is the only constitutional basis for the income tax law of October 3, 1913. That constitutional amendment was never a part of the Constitution of the United States, until it was proclaimed to be such by the Secretary of State on February 25, 1913. It was on that day that Congress first acquired power to enact any such statute, as the present income tax statute. But Congress never exercised that power until October 3, 1913. On that day, it had power to enact a statute to lay and collect taxes on *incomes,* though it never had any power,

in pursuance of the Sixteenth Amendment, to lay and collect any tax on anything *except* incomes. But no money which had been received by any person or corporation prior to October 3, 1913, could be constitutionally made subject to an income tax law enacted on that day; for that money had become capital in the hands of that person before that day, and indeed may have already become outgo. An income tax statute can operate only *in futuro;* because it can operate only on money to *come in* after its enactment. If it could operate upon money which had come in before its enactment, it would not be operating upon *the act of coming in,* but would be operating upon *the status of being in.* The difference between an income tax and a tax upon property, is the difference between a tax upon an active transaction, and a tax upon a static condition. No income tax statute can operate upon a static condition which existed before its enactment; for if it could, it would be operating upon property and not upon income, and therefore would not be an income tax statute at all. And Congress has no constitutional right to levy any tax on *property;* without apportioning that tax among the several States, according to their respective numbers; which proposition the Supreme Court decided in the Pollock case, and which apportioning is absent from the income tax statute of October 3, 1913.

The law which was established by this decision was not affected by subsection T, of Section IV, of the Federal tax law of October 3, 1913, which section reads as follows: "If any clause, sentence, paragraph, or part of this Act, shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair or invalidate the remainder of

this Act, but shall be confined in its operation to the clause, sentence, paragraph or part thereof, directly involved in the controversy in which such judgment shall have been rendered." For subsection T, has its operation in saving Sections I, III, and IV of the statute, from the invalidity of Section II.

For the reasons thus far stated under this section of our criticism, it follows that the income tax statute of October 3, 1913, is inoperative in respect of the seven months and two days which last preceded its approval by the President.

The reasons why that income tax statute is also inoperative in respect of the two months and twenty-eight days of the year 1913, which followed its approval by the President, are the following: The first proviso of subsection D, of the statute enacts: "That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions provided for by the statute."

Now, if the Commissioner of Internal Revenue were to attempt to apply the statute to the two months and twenty-eight days in October, November and December, nineteen hundred and thirteen, which followed its enactment, he would have no authority for deducting from the gross income of any person or corporation, during those two months and twenty-eight days, any particular fraction of the specific exemptions and deductions, to which that person or corporation would be entitled, if the gross income, and also the exemptions and deduc-

tions of that party, were to be calculated for the whole of the year 1913. If Congress had expressly confined the operation of the income tax statute during the year 1913 to the two months and twenty-eight days which followed its enactment by Congress, and its approval by the President; then Congress would have been obliged to provide that the exemptions and deductions in question should be calculated on the basis of what actually occurred in respect to them, during those two months and twenty-eight days; or alternatively, Congress would have been obliged to provide that those exemptions and deductions should be calculated on the basis of assigning to them 89/365 of what those deductions would have amounted to, if they had been calculated for the whole of the year 1913.

For these reasons, it is apparent, that nobody knows or can conjecture what enactment Congress would have made relevant to exemptions and deductions from gross income, if Congress had been avowedly legislating for the last two months and twenty-eight days of 1913, instead of avowedly legislating for the last ten months of that year. And it is also apparent that what Congress had power to do for the last two months and twenty-eight days of 1913, is so mingled in the statute with what it attempted to do without power, in respect of the seven months and two days which preceded the enactment and approval of the statute, that those two elements of the statute are inseparable, and that that inseparability operates to render the entire income tax statute inoperative as to the whole of the year 1913. The logic of the Supreme Court decision in the Pollock case. makes this conclusion inevitable; unless it is averted by some statute; and there is no statute which is adapted to have that effect.

CHAPTER II.

HISTORY.

The bill for the income tax statute of 1913, was composed and put together in the following method:

When the Democratic members of the Committee on Ways and Means of the House of Representatives, undertook early in 1913, to write a bill to become the United States tax statute of 1913, they committed the writing of the income tax portion of that statute, to one of their own number, the Hon. Cordell Hull of Carthage, Tennessee. At that time, Mr. Hull was forty-one years of age, and was a lawyer by profession, and for six years, had been a member of Congress. In constructing the framework of his income tax contribution, to the United States tax bill, Mr. Hull borrowed the scheme of collecting income taxes at their "sources," from the income tax law of the United Kingdom of Great Britain and Ireland. But he overlooked the fact that the Parliament which rules that kingdom, is not subject to any constitutional limitation; whereas the Congress of the United States is subject to many definite limitations, which are prescribed in the Constitution of the United States.

When Mr. Hull began to write his proposed income tax enactment, he wrote its first paragraph in the following words:

"That there shall be levied, assessed and paid annually, upon the entire net income arising or accruing from all sources in the preceding calendar year, to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United

States, though not a citizen thereof, a tax of one per centum per annum upon such income, over and above $4,000; and a like tax shall be assessed, levied and paid annually, upon the entire net income from all property owned and of every business, trade or profession, carried on in the United States by persons residing elsewhere".

But Mr. Hull overlooked the fact that the very first paragraph thus written by him, was self-contradictory, in respect of the income tax to be levied upon citizens of the United States, residing elsewhere. For the first part of his paragraph purported to provide that every such citizen shall pay a tax of one per centum per annum upon *his entire net income from all sources;* whereas the latter part of his paragraph purported to provide that every such citizen shall pay a tax of one per centum per annum only upon *his entire net income from all property owned and of every business, trade or profession carried on in the United States.* The difference between these two provisions, is vitally important to many citizens of the United States, residing in foreign countries. For example, there are nearly a hundred citizens of the United States who permanently reside in France, and practice dentistry there, and receive nearly or quite all of their incomes, in compensation for professional work performed by them in Paris, and mainly performed for citizens of France. According to the first part of Mr. Hull's first paragraph, those American dentists must send every year to the United States treasury, one per cent of their entire net incomes earned in France; whereas according to the latter part of his paragraph, none of those American dentists are required to pay any income tax on any of their earnings received by them

for professional services performed in any foreign country.

This contradiction between the first part and the second part of Mr. Hull's first paragraph, constitutes evidence of incapacity in that statesman to accurately frame, even one short statutory paragraph. And the fact that his error was never corrected by the Committee on Ways and Means, or by the House of Representatives, or by the Finance Committee of the Senate, or by the Senate itself, or by the Conference Committee between the two houses, or by the President of the United States, and is in the income tax statute now; constitutes convincing evidence that most of the personages whose will operated to carry Mr. Hull's work into the statute books, failed to subject that work to any critical examination, before they made it into law.

The tax bill of 1913, which was prepared by the Democratic members of the Ways and Means Committee of the House of Representatives, and which was named the Underwood Bill in honor of the chairman of that committee, and the income tax section of which was written by Mr. Hull; was passed by the House and sent to the Senate, and referred to its Finance Committee, on May 8, 1913. That Committee reported that bill to the Senate with amendments on July 11, 1913. Those amendments did not include any systematic reorganization of the income tax section, which Mr. Hull had prepared and which the House had passed. Quite otherwise than so doing, those amendments included a large number of miscellaneous patches, put promiscuously upon Mr. Hull's text; sometimes by way of addition thereto, and sometimes by way of substitution for some portions of that text, which were cut away to make places for those patches.

The entire bill, thus reported with amendments from the Senate Finance Committee, was under some considerable consideration in the Senate, during nearly two months, until it was passed by that body on September 9, 1913, with some amendments. During that consideration, but little attention was given to the income tax section of the bill. And no important amendment was made in that section, prior to its passage by the Senate; except in respect of the steps in the graduated scale of incomes, subjected to the "additional" tax.

But the bill as a whole, as it passed the Senate, on September 9, 1913, contained many hundreds of differences between it, and the bill which passed the House on May 8, 1913. Thereupon, the two bills were referred to a Committee of Conference between the two houses, which Committee was composed of four of the Democratic and two of the Republican members, and of Mr. Murdock, of Kansas, the Progressive member, of the House Committee on Ways and Means, and of four of the Democratic and three of the Republican members of the Senate Committee on Finance. Thereupon, the Democratic members of that Conference Committee assembled alone in a committee room, and proceeded to review the two bills, and to patch together a third document, to represent them both, and to agree to vote to report that third document to the two Houses, respectively. This being done, those gentlemen invited the other six members of the Conference Committee into their room, and submitted to them that third document, for their consideration. But instead of giving any of them any time or opportunity for any such consideration, the chairman of the Conference Committee promptly put to a vote, the question whether the third document should be reported to

the two Houses; upon which question the Democratic majority voted in the affirmative, and all the minority members in the negative; and thus that third document was technically "agreed to" by the Committee of Conference on September 29, 1913, but against the protest of its minority members.

At that time, that third document was not any consecutive and fair copy of anything, but was composed of a mass of heterogeneous matter, on numerous sheets of paper, which were loosely connected together, as far as they were connected together at all. Thereupon that heterogeneous collection of sheets, was sent to the Government printing office to be printed for the information of the two Houses, when they should come to consider the report of the Conference Committee. Within a couple of days thereafter, the Government printing office furnished the two Houses with a printed copy of whatever its compositors and proof readers could make out of that heterogeneous mass of papers. That printed copy constituted two hundred and forty-two pages, each of which, not including its margins, was five inches by nine inches in dimensions, so that the document contained more than ten thousand square inches of printed matter.

The income tax section of the copy occupied fifty-four of those pages, with more than two thousand square inches of printed matter; but that printed matter did not present any consecutive composition from end to end. Quite otherwise than this, it was composed of more than eleven thousand words, partly in large Roman type, and partly in small Roman type, and partly in Italic type; the words in large Roman type representing the bill as it was written by Mr. Hull; and the indicated cancellations of much of that matter, plus the words in Italic

type, representing the patching done by the Senate Finance Committee; and the words in small Roman type, plus the indicated cancellations of many of the words in large Roman type, and plus the indicated cancellations of many of the words in Italic type, representing the final crazy quilt of words and phrases, which resulted from the repatching which was done by the Democratic members of the Committee of Conference.

It was this volume of two hundred and forty-two pages of partly cancelled and sadly confused language that constituted the United States tax bill of 1913, when it passed both Houses of Congress. After that passage, a fair copy of it was submitted to the President for his consideration. He did not consider it long enough to read it through and understand it; for such a reading would have occupied his perfect attention many more hours than passed after he first saw it on the afternoon of October 3, 1913, and before he signed it at 9.10 o'clock in the evening of the same day.

CHAPTER III.

CHARACTER.

The income tax statute, as it was signed by President Wilson, on October 3, 1913, has the following character, as a specimen of statute writing.

Many of its sequences of words which are nominally sentences, are so complicated and incoherent that they cannot be parsed, or otherwise analyzed by means of any set of rules of English grammar. And what is worse, the elements of the statute are so unsystematically connected and disconnected, that no accurate and complete

knowledge of its purport, can be achieved by any man without many days of hard study. Though many millions of copies of its full text have been printed and published and examined, during the four months of its statutory existence, it is not probable that twenty men in the world, understand it even now.

For example, the obscure and complicated subject of income taxation at the "sources" of incomes, makes its very first appearance in the middle of a sentence, just after a semi-colon, in the middle of a proviso, in the middle of a paragraph, in the middle of subsection D; though that subsection refers to many subjects which have no more relevancy to income taxation at the "sources," than they have to many other parts of the income tax statute. That difficult subject having thus been introduced by a semi-colon, it is dropped in favor of other topics, long before the end of the subsection. It next comes to the surface of the muddy statute, at the beginning of the second paragraph of subsection E, and thence it runs on through its ambiguous course, to the end of that subsection.

It is very difficult to reconcile with each other, all the provisions of subsections D, and E, relevant to income taxation at the "sources" of the incomes; and very few men are supposed to have worked long enough and hard enough at that task, to see through the fog of words and phrases which they tried to penetrate in that endeavor.

All those ambiguous provisions were in the bill as written by Mr. Hull, and passed by the House of Representatives on May 8, 1913; but the Senate Finance Committee and the Senate itself, discarded most of Mr. Hull's subsection E, and otherwise so changed its provisions, and those of subsection D, as to make them much

less burdensome to the people, than they were before. The Committee of Conference, however, repudiated everything which had been done by the Senate committee and by the Senate, to improve subsection E; and it stands in the statute, exactly as it was passed by the House on May 8, 1913. So also, those parts of subsection D, which refer to income taxation at the "sources", are about the same in the statute that they were in the bill as it was written by Mr. Hull.

The New York Times of January 30, 1914, published the following telegram, conspicuously displayed on one of its pages:

"WASHINGTON, Jan. 29.—Representative Underwood, of Alabama, Democratic leader of the House, in a statement today, served notice that there would be no tinkering with the new tariff law at this session of Congress.

"His declaration was called forth as a result of the introduction of bills in the House within the past few days, which would repeal the 'collection at the source' feature of the Income Tax act. 'It is safe to say,' Mr. Underwood asserts, 'that no bills affecting the new tariff will have consideration at this session. The Income Tax law is a part of the new tariff law.' "

"Representative Hull of Tennessee, author of the Income Tax law, said today that 'complaints of its administration were premature,' and urged that criticisms be withheld until the law had been fully tested."

It appears in this telegram that Mr. Underwood, a Representative in Congress from Alabama, has assumed jurisdiction to not only prohibit Congress from correcting any of the numerous errors which have been dis-

covered by numerous citizens in the income tax law, since it was signed by President Wilson on October 3, 1913, but Mr. Underwood also proposes to prevent Congress from even considering any bill to correct any of those errors. Moreover, it appears that on January 29, 1914, Mr. Underwood "served notice" on the whole nation that its hundred millions of people must relinquish any hope they may have had of relief from those errors, at least in respect of their income taxes for the year 1913. The history of the United States will have to be searched, at least as far back as the administration of Andrew Johnson before any case can be found in that history of another announcement so autocratic as having ever been made by any leader of either house of Congress. During that administration, Representative Thaddeus Stevens took at times a lofty and dictatorial tone in his pronunciamentos, but Mr. Stevens was a venerable man of great sagacity; and besides, when he spoke he represented the opinions and wishes of the majority of the people, instead of setting up his will against those wishes and those opinions.

In this telegram to the Times, Mr. Hull, a Representative in Congress from Tennessee, takes a tone which is as modest as Mr. Underwood's tone is somewhat concentric. Mr. Hull seems inclined to ask the nation to shut up its eyes and stop up its ears, while the Commissioner of Internal Revenue administers the income tax law long enough to demonstrate by actual experience how bad it really is. But the foregoing critical paragraphs upon his work were written and sent to the printer before Mr. Hull published his request that all criticisms of his statute should be withheld until that statute is fully tested; and his expression of a wish for

silence does not seem to be an adequate reason for suppressing those paragraphs.

Moreover, Mr. Hull, when he wrote the bill for the income tax statute, made a mistake which still remains to be mentioned, and which resides in the statute as enacted, and which can not be cured by the Commissioner of Internal Revenue in administering that statute, and which, unless it is cured by an amendment to the statute made by Congress and signed by the President, before the end of February, 1914, will operate to inflict flagrant injustice upon a large number of persons in Ohio, and upon a considerable number of individuals residing in other states. That blunder has had the following history, and is as follows:

Subsection B, of Mr. Hull's draft of a proposed income tax statute, prescribed the method of computing the taxable incomes of *persons,* by making a series of classes of deductions from their gross incomes, respectively. One of those classes of deductions was defined by Mr. Hull as "losses actually sustained during the year, incurred in trade, or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise." But when Mr. Hull came to write his subsection G, and to prescribe therein the method of computing taxable incomes of *corporations* by making a series of classes of deductions from their gross incomes, respectively; he defined the class consisting of losses in the following language: "all losses actually sustained within the year, and not compensated by insurance or otherwise."

These two definitions differed from each other in a very important respect, which discriminated against in-

dividuals and in favor of corporations. That discrimination consisted in the fact that the deductible losses of *persons* were confined to those incurred in trade, or arising from fires, storms or shipwrecks; whereas the deductible losses of *corporations* were not limited at all, and included losses caused by robbery or other crimes, and those involved in railroad wrecks, and those inflicted through earthquakes or floods. And these discriminatory definitions were never changed by the Committee on Ways and Means of the House, or by the Finance Committee of the Senate, or by either of those Houses of Congress; and they were both incorporated in the income tax statute as it was enacted, and as it was approved by the President.

It results from this plutocratic discrimination between persons and corporations that any *corporation* in Dayton, Ohio, which incurred heavy losses in the flood which so nearly submerged that city in the spring of 1913, is entitled to deduct all those losses from its gross income from that year, when computing its taxable income; whereas any *person* engaged in any competing business in that city, or indeed in any business whatever, who incurred heavy losses in the same flood, is not entitled to deduct any of those losses from his gross income for that year, when he is computing the income taxes to be paid by him. The practical result of this legislation, if enforced, will be to compel all such persons to pay in June, 1914, income taxes on all the property which they lost in the flood of April, 1913.

And what is true of the flood in Dayton, Ohio, is equally true in respect of every other flood which caused losses in that state, or in any state during the spring of 1913. And what is true in respect of losses in floods anywhere in the United States in the spring of 1913, will

always be true of losses in floods and of losses caused by robbery or other crimes, and of losses involved in railroad wrecks or earthquakes, anywhere in the United States, as long as the income tax statute of October 3, 1913, remains unrepealed, unamended and not invalidated. For the Commissioner of Internal Revenue has no authority to remove, from the administration of the statute that undeniable discrimination in favor of corporations and against individuals.

Mr. Hull's request that all criticism of his statute be withheld till it has been fully tested, is a wrong request. On that principle, Guiteau could have had a suspension of criticism, till the result of his shooting of Garfield could be tested by months of struggle between life and death.

CHAPTER IV.

ADMINISTRATION.

The administration of the income tax law by the Commissioner of Internal Revenue has thus far been even more blundering and incompetent than was the writing of that statute by Congressman Hull; which truth is partly indicated by the following example:

On November 15, 1913, I wrote and mailed a letter to Mr. W. H. Osborn, Commissioner of Internal Revenue, Washington, D. C., in which I called his attention to page 9 of the pamphlet of "Regulations" which he had issued on October 25, 1913, and in which I pointed out that his "Regulation" on that page, expressly announced that "Non-resident foreigners owning interest bearing bonds are not subject to taxation on income from such bonds," provided they will sign and furnish certificates for them-

selves to the effect that they *are* non-resident foreigners. I also pointed out to Mr. Osborn in that letter, that that proposed exemption of non-resident aliens from United States income taxes on the interest drawn by them from corporations organized and doing business in the United States, was a discrimination in favor of those non-resident aliens, as against all American citizens; and I also stated to the Commissioner in the same letter that no such discrimination was expressed in the income tax statute, and that it was plain enough, in the absence of any statutory authority therefor, that no administrative officer was justified in making any such discrimination.

On November 20, 1913, not having received any reply to my letter of November 15 to Mr. Osborn, I wrote to him again upon the same subject, and called his attention to that decision in the Erie case which was written more than thirty years ago by Mr. Justice Bradley in the Supreme Court of the United States, and which, as I told him, is printed on pages 703, 704 and 705 of Volume 106 of the Reports of the Supreme Court of the United States. I told Mr. Osborn in that letter, that that decision was based upon the Civil War income tax statute, and that it related to the question of the taxability under that statute, of coupons upon bonds which had been issued by the Erie Railway Company, and which bonds and coupons were owned by non-resident aliens. I also told the Commissioner that the decision held that money due on those coupons to those non-resident aliens was "property in the United States," and was taxable as such under the United States income tax statute of that time. I also pointed out to Mr. Osborn that the income tax statute of October 13, 1913, also prescribes its taxation upon "property owned in the United States" by persons residing elsewhere, and that the intention of

Congress to include the bonds of corporations doing business in the United States in the category of "property owned in the United States," is indicated by the fact that in several places in the income tax statute the phrase "capital invested within the United States" is used as an equivalent for the phrase "property owned in the United States."

Having thus, in two successive letters, fully presented this vastly important matter to Mr. Osborn, I summed up my statements in the following paragraph:

"For these reasons, it is perfectly plain and it is undeniable, that your proposal to exempt non-resident foreigners, owning interest bearing bonds, issued by corporations in the United States, from that income tax, which everybody else owning such bonds must pay, is a proposition which is contrary to the plain meaning of the statute itself, and is also contrary to the decision of Justice Bradley, which I am bringing to your knowledge in this letter."

I never received any reply to either of my letters to Mr. Osborn on this subject until twenty-one days after the first of them was written, which was sixteen days after the second one was written. That reply reached me on December 7, 1913, and though it was signed "W. H. Osborn, Commissioner," it evidently was not composed by him, for it had written upon it the initials of deputy commissioner Luther F. Speer and also the initials of three clerks, and it had in typewriting, the initials of another individual, who was probably the typewriter operator, who really wrote the letter. But whoever may have been the author of the communication, he did his work so carelessly that he dated the letter "November 6, 1913," instead of December 6, 1913. Moreover, that letter, in

response to my elaborate communication of November 15 and November 20, was merely perfunctory, as will appear from reading its forty-five words, as follows:

"This office is in receipt of your letter of the 20th ultimo, in which you express yourself forcibly as to the matter of exempting interest income from American corporations to nonresident aliens from the payment of the income tax. Your suggestion will be given consideration."

If the Commissioner of Internal Revenue, ever did give any consideration to this subject, no equity resulted therefrom; for his "Instruction" No. 1, on the back of his "Form" 1040, omitted to cure the error, and left page 9 of his "Regulation" of October 25, 1913, in full force, with the results which are set down on pages 39 to 41, of this pamphlet.

The man who really runs the income tax business in the office of the Commissioner of Internal Revenue is Mr. Luther F. Speer, who has been a clerk in the Treasury Department for twenty years, and who prior to the enactment of the income tax statute of October 3, 1913, had charge of the collection of the corporation tax, under the statute of 1909. While the Hull proposition for an income tax law was pending in Congress, Mr. Speer wrote a pamphlet explaining Mr. Hull's bill, as he understood it. About the time the Committee of Conference agreed upon their report to be submitted to the two houses, relevant to the whole United States tax law of 1913, Mr. Speer revised his pamphlet, with a view to make it match the income tax portion of that bill, as he foresaw it would soon be adopted by the two houses of

Congress. And on the third day after October 3, 1913, when President Wilson signed that bill, Mr. Speer published his pamphlet, through the Corporation Trust Company of 37 Wall Street, New York City.

The Walker pamphlet of October 16, 1913, which is entitled "The Income Tax Law of the United States of America, Analyzed and Clarified," contained and still contains an "Insertion" of thirteen pages, devoted to pointing out and proving the existence of fourteen important errors in that Speer pamphlet. Inasmuch as Mr. Speer is now the deputy commissioner who has charge of administering the income tax law, it is important to ascertain and state whether he still adheres to all of those fourteen errors, or whether he has renounced some or all of them. To this end I have carefully compared those fourteen errors with the directions which he has printed on the faces, and with the "Instructions" which are printed on the backs, of his income tax return "Forms," 1030, 1031, 1032, 1033, 1034, 1035, 1040 and 1041, and I find that Mr. Speer has already renounced more than half of those errors; and has materially modified all the others, except those which, in the Walker pamphlet are numbered Second and Third.

But the administration of the income tax law, which is being conducted in the name of the Commissioner of Internal Revenue, contains scores of other deviations from the directions of that statute, and is therefore illegal in scores of particulars. Those illegalities consist in wrong directions to taxpayers, how to write their income tax returns. The best way in which to point out those errors, is to show how the statute requires those returns to be written; and to contrast its provisions, with the "Instructions" and other directions which have been

promulgated in the name of the Commissioner of Internal Revenue. That therefore is the work which is recorded in the next twenty thousand words of this pamphlet; which are not more numerous than the facts themselves, and the great importance of those facts, require them to be.

PART TWO.

INCOME TAX RETURNS

INTRODUCTION.

The income tax statute casts upon the taxpayers the function of writing their respective income tax returns. Uniformity of arrangement of the statements and statistics which constitute the income tax returns of each class of taxpayers, is necessary to economy in the administration of the income tax law; and such uniformity of arrangement can be attained only on blank "Forms," contrived by one person, or one council of persons. It is for this reason that the income tax statute casts upon the Commissioner of Internal Revenue the function of contriving such "Forms" and prescribing them to the taxpayers.

Such a "Form" properly consists of a systematic arrangement of spaces, on a sheet of paper, for the reception of Arabic numerals, and also of a word or a number of words, printed opposite to those spaces, respectively, to show what particular moneys are to be represented by the numerals which are to be written into those respective spaces, in order to enable the taxpayer to systematically set forth, in his income tax return, all the statements and statistics which the income tax statute requires him to record therein.

But the Commissioner's function to contrive such a Form, and his power to prescribe it to the taxpayer, do

not include any function or power to effectively print thereon, any word or words which, if followed by the taxpayer, *will carry his income tax return out of conformity with the income tax statute.* And as the statute imposes upon the taxpayer the duty, at his peril, of making his return conform to the statute, and also requires him to make a solemn written oath or affirmation that it does so conform; it follows that he must judge for himself, whether the words which the Commissioner may have printed, on the face of one of his "Forms" to indicate the meaning of the numerals opposite thereto, are true or are erroneous, when compared with the requirements of the statute. When a taxpayer is making out his income tax return he must be guided by the Commissioner of Internal Revenue in respect of the *form* of that return; but the law casts the responsibility of its *substance* upon that taxpayer alone. No official person has any power to interfere with any taxpayer when he is trying to carry that responsibility, according to his own honest opinion, or according to the advice he honestly receives from any lawyer or other person, on whom he chooses to rely for guidance.

The income tax statute does not confer upon the Commissioner of Internal Revenue or any other official personage, any jurisdiction to instruct any taxpayer upon any point of law. Every taxpayer must rely upon the income tax statute, for his guidance on every point of law which he needs to know, when making up his income tax return. In his efforts to learn the meaning of that statute, he may take information and advice wherever it is presented; but nobody has any power to bind his action with any instruction on any point of income tax law.

The Commissioner of Internal Revenue has prescribed and is publishing a "Form" for the use, in making up their income tax returns, of each of the classes of persons and corporations which are subject to the income tax statute. In so doing he acted within his official jurisdiction. But he also ventured to print, on the faces of those "Forms," many words and phrases for the guidance of taxpayers in performing their duties under the income tax law; and he even went so far beyond his jurisdiction, as to print on the backs of each of those "Forms," an elaborate code of "Instructions" on points of income tax law.

Many of the directions which the Commissioner thus printed on the faces of his "Forms," and many of the "Instructions" which he thus printed on their backs, are harmonious with the income tax statute; and those may be useful as pieces of advice, though not entitled to be designated "Instructions." But much of that gratuitously printed matter is discordant with the income tax statute; and some important parts of it are exactly opposite to what the statute expressly enacts. In every such particular, it is the right, and indeed the duty, of the taxpayers to follow the statute, and discard the guidance and repudiate the "Instructions" of the Commissioner.

It is the purpose and the plan of this pamphlet; to criticise the Commissioner's "Forms" in a convenient order; and to show the taxpayers exactly wherein the "Instructions" and other directions which are printed on their respective backs or faces, are wrong; and also to point out precisely how each of those "Forms" can be used, in conformity to the income tax statute, and thus made to show the taxable income of the user, with-

out showing that exaggeration of that income which will follow every obedience to the erroneous "Instructions" or other erroneous directions of the Commissioner of Internal Revenue.

SECTION 1.

Relevant to Natural Persons.

"Form" 1040 is a printed sheet of paper, ten and one-half by sixteen inches, adapted to be folded as two leaves, each of which is ten and one-half by eight inches, and the four pages of which leaves are numbered 1, 2, 3 and 4, respectively. Each of those pages is occupied by printed matter, which is too complicated to be self-explanatory. Pages 1, 2 and 3 include several blank schedules, which when filled out with figures to indicate sundry widely differing sums of money, will constitute the income tax return of the particular person filling out those schedules. But the lower two-thirds of page 3 is occupied by two blank affidavits the first of which may be executed by a person making his own income tax return, or the second of which may be executed by a duly authorized agent of the person whose income tax return is represented by the filled out schedules.

The schedule on page 2 is devoted to "Gross Income". The schedule on the upper one-third of page 3 is devoted to "General Deductions". Line 1 of the schedule on page 1 is devoted to "Gross Income" and is adapted to be filled out with the figures which constitute the footing of the schedule on page 2. The second line of the schedule on page 1 is devoted to "General Deductions"

and is adapted to be filled out with the figures which constitute the footing of the schedule on page 3. The third line of the schedule on page 1 is entitled "Net Income"; and is properly to be filled out with the figures which constitute the remainder, after the figures in the second line are subtracted from the figures of the first line. That phrase "Net Income" is an arbitrary one, which does not indicate that income of a person upon which the normal income tax of one per cent is calculated, but indicates a larger amount. Lines 4, 5 and 6 of the schedule on page 1 are respectively devoted to three deductions, always one and often two, and sometimes three of which may properly be made from the amount of the above mentioned "Net Income", in order to ascertain the "Taxable Income" on which the normal tax of one per cent is calculated, in the case of every person, and which taxable income is the subject of line 7 of that schedule.

Where the amount entered on line 3 of the schedule on page 1 exceeds $20,000, that part of the schedule of page 1, which is below line 8, must be filled out to represent that excess and to represent the "additional" income tax which, according to the statute, must be paid upon any such excess. According to the statute that "additional" income tax is one per cent upon the first $30,000, or fraction thereof of such an excess; and on the next $25,000 or fraction thereof it is two per cent; and on the next $25,000 or fraction thereof it is three per cent; and on the next $150,000 or fraction thereof it is four per cent; and on the next $250,000 or fraction thereof it is five per cent; and on any still further amount, that "additional" tax is six per cent.

The last three lines of the schedule on page 1 of Form 1040 provide places for inserting the amount of the

normal tax, and for adding the additional tax, if any, to the normal tax, so as to show, in the last of those three lines, the total tax liability of the person.

The foregoing explanation of the schedules on pages 1, 2 and 3 of Form 1040, is enough to enable any person to use that form in making up his income tax returns. But if any person is going to make his income tax return according to the income tax law, he must make some changes in some of the words which are printed on the faces of those schedules. Those changes are the following:

First.—In item 4, near the middle of the schedule on page 1, he must cancel the words "or accrued of," and substitute therefor the word "from." This is necessary, in order to make that item 4 correspond with item 11 of the schedule on page 2, of which that item 4 purports to be a condensed paraphrase. That item 11 is correct; but that item 4 is not correct, because it erroneously states that that item 11 includes moneys which have "accrued," together with moneys which have been derived or received by the person making the return. That item 11 properly omits to include any money which has "accrued" to a taxpayer without being received or derived by him. But although the amount of money to be entered in that item 4 is to be copied from the amount entered in that item 11, it purports in item 4 to include money which is not included in item 11.

Second.—In item 2, of the schedule on page 2, he must cancel the word "bonds," because that word includes *all* bonds, and because the first clause of the last paragraph of subsection B, of the statute, expressly ex-

cludes from income taxation, all United States bonds, all State bonds, and all municipal bonds, as well as all other obligations of a State, or any political subdivision thereof, or of the United States or any of its possessions.

Third.—In item 3, of the schedule on page 2, he must insert the word "taxable" before the word "securities," so as to exclude from that item those securities or obligations which are exempted from income taxation by the first clause of the last paragraph of subsection B, of the income tax statute.

Fourth.—In item 7, of the schedule on page 2, he must insert the word "taxable" before the word "income," in order to exclude from that item all those pieces of non-taxable income which may be received by a taxpayer from some trustee or other fiduciary party. Such pieces of non-taxable income include all interest upon United States bonds, State bonds or municipal bonds; and all money acquired through some fiduciary party by gift, bequest, devise or descent, and all proceeds of life insurance policies paid through any fiduciary party upon the death of any person insured; and all payments made through any fiduciary party upon any life insurance, endowment or annuity contract, at the maturity of that contract, or upon its surrender.

Fifth.—In item 8, of the schedule on page 2, he must insert the word "taxable" before the word "income" in order to exclude from the amount of money entered opposite to that item all of the non-taxable income which the person making the return may have received. The pieces of that non-taxable income may be any or all of

the following: All interest received upon any obligation of the United States or any of its possessions, or of any State or of any political subdivision thereof; all money and other property acquired by gift, bequest, devise or descent; all proceeds of life insurance policies, paid upon the death of the insured; and all repayments made to holders of life insurance, endowment or annuity contracts, upon the maturity or surrender of such contracts. The non-taxability of all such pieces of income is expressly enacted in subsection B, of the income tax statute.

Sixth.—In item 2, of the schedule on page 3, he must change the words "on personal indebtedness of taxpayer" to the words "by a taxable person on indebtedness," in order, to restore to its statutory scope, the language which the Commissioner of Internal Revenue undertook to limit, by changing the statutory language. That language is in the second paragraph of subsection B of the statute, and is as follows: "all interest paid within the year by a taxable person on indebtedness." This language plainly includes interest paid by a taxable person on the indebtedness of some other person or persons, as well as interest paid upon his own indebtedness; which vicarious payments, many persons are every year compelled to make, as endorsers or guarantors of the notes or other obligations of other persons. The statute plainly allows any taxpayer to deduct from his gross income, all such payments of interest made by him, as well as to deduct payments of interest upon his own indebtedness. But item 2, of the schedule on page 3, without the slightest authority in the statute, limits all deducted interest, to interest paid on the personal indebtedness of the taxpayer.

The forms of affidavits which are printed on the lower two-thirds of page 3, of Form 1040, differ so extensively from what the statute provides in respect of such affidavits, that it is not practicable to amend them on their faces, into conformity with the statute. Nobody can truthfully make either of those affidavits, whether he shall have filled out the schedules on pages 1, 2 and 3 of Form 1040, exactly as directed on their faces, or whether he shall have amended those schedules in any or all of the six particulars which are specified above. In any case, any person may properly refuse to make either of the affidavits printed on page 3, of Form 1040.

In any case a proper and legal substitute for the first of those two affidavits may be drawn as follows:

I solemnly swear (or affirm) that the foregoing schedules, which are partly in print and partly in pen-writing or typewriting, constitute a true and accurate return, according to the best of my knowledge and belief, such as is required of me by the income tax law of the United States of America, which was approved October 3, 1913; and that my gross income, during the year for which the return is made, is truly stated therein, according to that statute, and according to the best of my knowledge and belief; and that, according to the best of my knowledge and belief, I am entitled to make, in my said return, all the deductions specified therein, from my said gross income.

So also, a proper and legal substitute for the second of those two affidavits may be as follows:

I solemnly swear (or affirm) that I have sufficient knowledge of the income of

to enable me to make a true and accurate return for that person, in accordance with the income tax law of the United States of America, which was approved

October 3, 1913; and that the foregoing schedules, which are partly in print and partly in penwriting or typewriting, constitute a true and accurate return, according to the best of my knowledge and belief, such as is required by that statute to be made by or for that person; and that, according to the best of my knowledge and belief, the gross income of that person during the year for which the return is made, is truly stated in that return, according to that statute, and that, according to the best of my knowledge and belief, that person is entitled in said return, to all the deductions specified therein from said gross income.

Those faults in the Commissioner's forms of affidavits which are contrary to the statute, and are absent from the above suggested substitutes, are the following:

First: The Commissioner's forms state that "the foregoing return" contains "a true and complete statement of all gains, profits and income *received*" by the person making the affidavit, or by the person on whose behalf it is made, as the case may be; whereas the statute, in its subsection B, provides: "That the proceeds of life insurance policies paid upon the death of the person insured, or payments made by or credited to the insured, on life insurance, endowment or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract, or upon surrender of contract, shall not be included as income"; and that subsection also provides that the value of property acquired by gift, bequest, devise or descent shall not be included in the gains, profits and income to be reported to the Commissioner of Internal Revenue; and subsection B, also provides that in computing net in-

come, there shall be excluded the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions. Thus all of these classes of income are exempted, by the income statute, not only from the payment of any income tax, but also from being included in the gross income of any individual making an income tax return. But the forms of affidavit furnished by the Commissioner of Internal Revenue would make any individual swear or affirm that all those classes of exempt income are stated in his income tax return.

Second: The forms of affidavit furnished by the Commissioner, state that "the foregoing return" contains "a true and complete statement of all gains, profits and income *accrued*" to the individual making the affidavit, or by the individual for whom it is made, as the case may be; whereas the statute does not provide that any gross income which merely *accrued* to anybody at any time, shall be included in any income tax return, except where profits are left undivided for an illegitimate reason, and then only in respect of the "additional" tax. And the eight classes of gross income which are specified on page 2 of Form 1040, as including all the gross income which an individual is required to state in his income tax return, are all confined to income *"derived"* or *"received"*, and are totally destitute of suggestion that income which merely *"accrued"*, ought to be included in any of those items.

Page 4 of Form 1040, is occupied by 20 "Instructions", which are furnished by the Commissioner of Internal Revenue, to tell taxpayers what statements to insert in the "Form" on pages 1, 2 and 3, and what

statements to omit therefrom, and also how to conduct themselves in some other respects.

Instruction No. 1, is misleading in respect of what it tells non-resident aliens to do about their income tax returns. According to that Instruction, such income tax returns are to be based upon income derived "from property owned and business, trade or profession carried on in the United States" by the respective non-resident aliens making the returns. This is misleading; because the third paragraph of subsection B, of the statute provides that net income from property owned and business carried on in the United States by persons residing elsewhere, shall be computed upon the basis prescribed by that subsection, and by that part of subsection G which relates to the computation of the net income of foreign corporations. And that part of subsection G which relates to that subject, prescribes that foreign corporations doing business in this country, shall in their income tax returns state "the gross amount of income received within the year from business transacted, and capital invested in the United States."

Now a non-resident alien who owns a bond of some railroad corporation, or some industrial corporation, or some other corporation, organized and operating in the United States, has capital invested in the United States, and is plainly taxable on the interest he receives on that bond, under the income tax law of the United States. But Instruction No. 1, instead of using the phrase "capital invested within the United States", uses the phrase "property owned in the United States."

And the Commissioner of Internal Revenue has made a "ruling", that the phrase "property owned in the United States" does not include any bond of any corporation organized and operating in the United States, and that the interest on such bonds, is untaxable *when the bonds are owned by non-resident aliens.* That ruling was expressed on page 9, of the Commissioner's "Regulations" of October 25, 1913; and has ever since operated to discriminate between citizens of the United States and non-resident aliens, in respect of interest on such bonds; taxing all such interest as against such citizens, and exempting all such interest from taxation, as against such aliens.

Even if the statutory language on this subject had been everywhere expressed by the phrase "property owned in the United States", that ruling would still be exactly contrary to one of the two opinions upon which the decision of the Supreme Court of the United States was based, in the case of the United States against the Erie Railroad Company; which opinion is printed on pages 703, 704 and 705 of Volume 106 of the United States Reports. If the Commissioner of Internal Revenue had used, in his Instruction No. 1, the statutory phrase "capital invested within the United States", he would have plainly told non-resident aliens that they must pay income taxes upon the interest received by them, on bonds of corporations organized and doing business in the United States. That information would have been entirely harmonious with the income tax statute, and with the decision of the Supreme Court, in the Erie case. But the Commissioner's "Instruction" No. 1, taken in connection with his "Regulation" of October 25, 1913, is contrary to that statute and to

that decision; and is thus contrary, upon a point which is going to cost the United States Treasury more than a million dollars every year. For the amount of bonds, which were issued by corporations organized and operating in the United States, and are owned by non-resident aliens is about three thousand million dollars; and the annual interest paid on those bonds is about a hundred million dollars; and the "normal" income tax and the "additional" income tax due on that interest is more than one million dollars. The Commissioner of Internal Revenue, is practically giving that amount of money, from the Treasury of the United States to non-resident aliens, without appearing to realize his own vicarious benevolence. But we shall soon see that, with equal guilelessness, he is proposing to collect a still larger sum, from citizens of the United States, in addition to what the income tax law requires those citizens to pay. He is proposing to "rob Peter for the benefit of Paul"; Peter being the citizenship of the United States, and Paul being those thousands of non-resident aliens, who are sucking a hundred million of dollars of United States money, every year away from our corporations into their own bank accounts and treasuries.

Instruction No. 11, relates entirely to the income tax returns of farmers. It provides that a farmer who buys an animal, and afterward sells it, must return as taxable income the excess of its proceeds over its purchase price, without any deduction from its proceeds on account of anything which he may have expended on it while he owned it.

This Instruction also provides that a farmer who raises an animal from its birth, and afterward sells it, must return as taxable income, the excess of its proceeds over "the amount of *money* actually paid as expense for producing it," without any deduction on account of anything else, which he may have expended upon it during its entire life.

This Instruction also provides that a farmer who produces and sells any other product, shall return as taxable income, the entire proceeds of its sale, without any deduction except "the amount of *money* actually paid as expense" for producing that product.

A farmer who does all his own work, with the help of his minor sons, and fertilizes his fields with manure from his own barnyard, and sows no seeds except those of his own production, and employs no power, except that of his own horses or oxen, is told by this Instruction, to return his entire gross income as taxable income, without any deduction on account of the cost of his products.

These requirements seem hard on American farmers; but the Commissioner of Internal Revenue had to do *something* to recoup the million dollars which he is remitting from the income taxes levied by the statute upon non-resident alien holders of American bonds. And no possible victims of extortion, are more unresisting, or more patient, than those farmers who labor under blazing suns, to evolve the food of the nation from the bosom of the earth. Moreover, this administrative discrimination against American farmers, will operate only on those whose incomes exceed $3,000 or $4,000 for the year in which the discrimination is perpetrated, and they are comparatively few.

Instruction No. 12 reads as follows: "In calculating losses, only such losses as shall have been actually sustained, *and the amount of which has been definitely ascertained,* during the year covered by the return, can be deducted." The nine words which are italicized in this quoted language, were interpolated by the Commissioner of Internal Revenue, without any authority in the statutory language; which language is plainly printed without those nine words in the second paragraph of subsection B, of the statute, as the fourth deduction allowed by law.

This interpolation by the Commissioner of Internal Revenue was absurd in addition to being unauthorized; for an individual, in making out his income tax return in January or February of one calendar year, for the preceding calendar year, might know that his losses in trade or arising from fires, storms or shipwrecks during that year, were greater than his gross income for that year, although the amount of those losses might not have been definitely ascertained before the end of February. In such a case, the statute permits the individual to refrain from paying any income tax for that disastrous year; but the Commissioner of Internal Revenue "instructs" such a suffering citizen that he must pay an income tax upon his gross income during that year, although that income may have been much exceeded by the losses resulting from a disastrous fire on the last day of December; unless the precise amount of the losses caused by that fire, shall have been made certain, before the end of February. Fortunately, however, the italicized words in the above Instruction No. 12 have no foundation in the statute, and may be properly ignored by the citizens of the United States.

Instruction No. 13 is as follows: "Persons receiving fees or emoluments for professional or other services, as in the case of physicians or lawyers, should include all actual receipts for services rendered in the year for which the return is made, *together with all unpaid accounts, charges for services or contingent income, due for that year, if good and collectible.*" The italicized words, in this Instruction, are totally destitute of foundation in the statute. Indeed they are contrary to the statute, because the statute provides that "income from salaries, wages or compensation for personal service of whatever kind," is taxable only when it shall have been *derived* and shall have been *paid.* The law on this subject is in the first sentence of the first paragraph of subsection B of the statute, and is there expressed as follows: "subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits and income *derived* from salaries, wages or compensation for personal services of whatever kind and in whatever form *paid.*"

The erroneous idea of the Commissioner of Internal Revenue on this point, appears to have entered his mind from the word "accruing," where it appears in the first paragraph, and also in the eighth paragraph of the statute in reference to the "net income" of a person. But in both those places, and everywhere else in the statute where the word "accruing" is similarly used, the implication is that a net income "accrues" from a gross income; though the gross income is everywhere said to be "derived" or "received" from the various sources of income which are specified in the statute. The statutory use of the word "accruing" is accurately proper, for the net income to which it is applied does "accrue" from

the gross income, through a process of successive deductions, which is prescribed by the statute as the proper method of ascertaining the amount of the net income which accrues from the gross income. But whether the Commissioner of Internal Revenue acquired his erroneous idea from this conjectural but unreasonable source, or acquired that idea by some other derivation, it is certain that nobody is bound to agree with him, or to follow his Instruction No. 13 on this point.

Instruction No. 14 is as follows: "Debts which were contracted during the year for which return is made, but found in said year to be worthless, may be deducted from gross income for said year, but such debts can not be regarded as worthless until after legal proceedings to recover the same have proved fruitless, or it clearly appears that the debtor is insolvent. If debts contracted prior to the year for which return is made were included as income, in return for year in which said debts were contracted, and such debts shall subsequently prove to be worthless, they may be deducted under the head of losses, in the return for the year in which such debts were charged off as worthless."

This "Instruction" is ambiguous; but the statutory language which it purports to represent is plain enough. That statutory language defines the fifth deduction which every individual is entitled to make from his statutory gross income, when ascertaining his statutory taxable income, as "debts due to the taxpayer, actually ascertained to be worthless and charged off within the year." Now when anybody takes time to translate Instruction No. 14 of the Commissioner of Internal Revenue into plain language, he will find that it probably has the following meaning:

"Debts which originated and were also ascertained to be worthless within the single year covered by an income tax return, may be deducted from gross income for that year, provided that legal proceedings to recover them have proved fruitless, or it clearly appears that the debtor is insolvent. If that proved fruitlessness or that clear appearance, shall not have been reached by March 1, of the next year, no deduction from gross income on account of those debts shall be made in the income tax return for the year in which the debts originated and were ascertained to be worthless; but if by March 1, of some future year, that proved fruitlessness or that clear appearance shall have been reached, then the amount of the old and worthless debts may be deducted as losses, in the income tax return for the year in which that proved fruitlessness, or that clear appearance was at last established."

This Instruction No. 14 differs from the statute, in the following respects:

First.—The statute allows worthless debts to be deducted from the gross income of any creditor for the calendar year in which they are ascertained to be worthless, regardless of whether those debts originated in that year or in some previous year; whereas the Instruction does not allow any worthless debt to be deducted from any gross income for 1913, unless it originated in that year, as well as being found in that year, to be worthless.

Second.—The statute authorizes debts due to any taxpayer to be deducted from his gross income, in ascertaining his taxable income, whenever such a debt is ascertained in the judgment of the taxpayer to be worthless, and is thereupon "charged off" by him in his account books; whereas the Instruction does not permit any such

deduction "until after legal proceedings to recover the debt have proved fruitless, or it clearly appears that the debtor is insolvent."

Either of these two requirements of the Instruction would impose hardship and loss upon many a creditor. The first requirement would involve the expense, the delay and the trouble which always attend litigation; and the second requirement, depending as it does upon appearances, would often be unattainable, even where debts would really be worthless.

For example, a debtor might abscond with the very money which the creditor had loaned him, without leaving any other debt behind him; in which case the creditor could not even begin any legal proceedings against him to collect the debt, and could not make it "clearly appear" that the debtor is insolvent. If, in such a case, the creditor is convinced that the debt is worthless, and thereupon charges it off from his books, the statute permits him to deduct its amount from his gross income, for the year in which the debtor absconded. But the Instruction would never permit the amount of that debt to be deducted from the gross income of the creditor, for any year, or at least not until the debtor would come back to be sued, or to make it clearly apparent that he is insolvent.

For another example, a debtor might clearly appear to be solvent, though poor, and not be able to pay his debt without thereby depriving his wife and children of necessary shelter, food or clothing; and his creditor might be unwilling to impose upon himself and the debtor the expenses incident to litigation, and rather than sue the poor man, might "charge off" the debt as worthless. In such a case the statute permits the debt thus charged

off to be deducted from the gross income of the creditor, for the year in which it was thus charged off. But the Commissioner of Internal Revenue would penalize the creditor for his forbearance, and compel him to pay an income tax upon the amount of the debt which he was too tender hearted and too sensible to try to enforce against the poor debtor.

And this is the same Commissioner of Internal Revenue, who in his Regulation of October 25, 1913, undertook to exempt from all United States income taxes, all those non-resident aliens who are receiving a hundred million dollars every year, as interest upon bonds of corporations organized and operating in the United States; and is the same Commissioner who undertook to do that thing, without any authority of law, and in the very face of the income tax statute itself, and of one of the opinions, upon which the decision of the Supreme Court of the United States in the Erie Railway case was based.

Instruction No. 17 reads as follows: "Estimated advance in value of real estate is not required to be reported as income, *unless the increased value is taken up on the books of the individual as an increase of assets.*"

The italicized last eighteen words of this Instruction imply that when the increased value of real estate *is* taken up on the books of the individual as an increased asset, the amount of that increment must be included in the gross income of the owner, for the year in which it occurred. This implied instruction has no foundation in the statute, and is contrary to that portion of the statute which relates to gross profits arising from increased value of real estate. That part of the statute is near the middle of the first paragraph of subsection B,

and provides that the profits arising from increased value of real estate, which are to be included in gross income, are the profits which arise from *sales* of or *dealings* in real property. The statute proposes to tax the income derived from real estate from year to year, which income naturally increases as fast as the value of the real estate increases. But the statute does not propose to tax any such increase of the value itself, until that increase is materialized in a sale of the property. To tax the increase of value and also to tax the increase of income due to the increase of value, would be multiple taxation. Moreover, if the statute were to tax any increase of the market value of real estate for one calendar year, it ought to make allowance for decrease of market value of the same real estate, during any later year in which its market value might depreciate. But the statute confines its allowance for depreciation of real property, or any other property, to physical depreciation caused by exhaustion or wear and tear, arising out of its use or employment; and does not allow any deduction on account of any decrease of market value, due to diminishing demand or to increasing competition.

Instructions Nos. 2 to 10, inclusive, and Instructions 15, 16, 18, 19 and 20, on the back of Form 1040, are proper enough as advice to be taken, though not as instructions to be obeyed. But Form No. 1040, as a whole, when analyzed and construed in connection with the code of twenty "Instructions" on its back, cannot be lawfully used by any individual, without those changes which are suggested and precisely described on pages 33 to 38, of this pamphlet, and except in the light of those comments upon those "Instructions," which are made on its pages 38 to 49, inclusive.

SECTION 2.

Relevant to Fiduciaries.

"Form" 1041 is a printed sheet of paper which has the same general appearance as Form 1040, but it differs therefrom in being devoted to income tax returns to be made by fiduciaries on behalf of taxpaying individuals, whereas Form 1040 is devoted to income tax returns to be made by individuals for themselves. That part of the statute which requires such returns to be made by fiduciaries, is in subsection D thereof, and is expressed in the following language: "guardians, trustees, executors, administrators, agents, receivers, conservators, and all persons, corporations or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals". The phrase "this tax" must refer to whatever tax is mentioned in the statute last preceding that phrase. That last mentioned tax is specified a few lines higher in the same paragraph as "the tax imposed by this section". And the word "section" is everywhere used in the statute to designate the whole income tax statute, which enactment is Section II, of the United States tax statute of October 3, 1913. That Section II, is printed in thirty-three paragraphs, arranged in fourteen groups, the first paragraph of each of which groups is prefixed by a capital letter, and all of which groups are arranged in alphabetical order, from A to N inclusive, and are designated in the statute as subsections.

The above quoted statutory language which imposes upon fiduciaries the duty to render income tax returns for the persons for whom they respectively act, and who are subject to the income tax statute, must, according to the quoted statutory language, perform that duty "subject to all the provisions of this section which apply to individuals". And we have just seen, that the word "section" wherever it is used in the income tax statute, signifies that entire statute.

It follows from these statutory provisions, that when any fiduciary is going to render an income tax return for the person for whom he acts, he must render that return in substantially the same shape, as if that person were rendering his income tax return for himself. But Form 1041, if followed by any fiduciary on behalf of a person whose total net income exceeds $20,000, is adapted to enable that person to escape the payment of the "additional" income tax, which Form 1040 provides for, in respect of individuals making their own income tax returns. Surprising as this may seen, Form 1041 does not contain any schedule in which any entry can be made by anybody relevant to any "additional" income tax. Indeed no mention or allusion to any "additional" income tax, is made anywhere on the face or on the back of Form 1041. That form was evidently constructed on the theory that no person whose income is controlled by some guardian, trustee, executor or other fiduciary, is required by the statute to have any additional income tax paid on his behalf; even where, as in many actual cases, the net income of such a person exceeds $20,000, and even where, as in some actual cases, such an income exceeds $100,000, and even where, as in a few actual

cases, such a net income exceeds $1,000,000 a year. That theory must have arisen from the notion that the phrase "this tax" where it occurs in the above quoted relevant statutory language, is confined to the normal tax imposed by the income tax statute. But that notion is destitute of foundation in the statute, and is quite inconsistent with the statutory provision in subdivision 2, of subsection A; which provides that, in addition to the normal income tax, there shall be levied, assessed and collected upon the net income of every individual, an additional income tax of one per cent per annum upon the amount by which the total net income exceeds $20,000; and so forth in respect of a graduated series of still larger incomes.

It is now in order to ascertain and state whether, and to what extent if at all, Form 1041 is adapted to be used by any fiduciary, in making out an income tax return for any person whose income does not exceed $20,000; and all further statements in this pamphlet relevant to Form 1041, are to be understood as being confined to that subject.

The schedule on page 2, of Form 1041, is devoted to "Gross Income". That schedule is substantially identical with the corresponding schedule on page 2 of Form 1040, except that it properly omits item 7 thereof, and renumbers items 8, 9, 10, 11 and 12, as items 7, 8, 9, 10 and 11. All the changes which are specified on pages 33, 34 and 35, of this pamphlet as being necessary to be made in the schedule on page 2 of Form 1040, must also be made in the schedule on page 2 of Form 1041, in order to render that schedule proper to be used by any fiduciary, when making out an income tax return for any

person for whom he is acting. Those are the changes which are specified on those pages as *second, third, fourth* and *fifth.* But the change therein specified as *fifth,* must be made in item 7 of the schedule on page 2 of Form 1041; for that item is identical with item 8, of the schedule on page 2 of Form 1040.

The first six items of the schedule on page 3 of Form 1041 are substantially identical with the first six items in the schedule on page 3 of Form 1040. All those six items are correct; except No. 2, which is incorrect in the respect and for the reason explained on page 35 of this pamphlet, in the paragraph headed with the word *"Sixth"*.

Items 7 and 8 of the schedule on page 3 of Form 1041, correspond with items 4 and 5 of the schedule on page 1 of Form 1040, and they are correct..

There should also be an item No. 9, in the schedule on page 3, of Form 1041, to correspond with item No. 6 of the schedule on page 1 of Form 1040; that item referring to the specific deduction of $3,000 or $4,000, as the case may be, which the statute allows to every individual whose net income does not exceed $20,000. The statute plainly provides that any such person, whose income is controlled by some fiduciary, is entitled to that specific reduction, equally with any such person who controls his own income, and makes his own income tax return. But Form 1041 contains no blank space for the insertion of any such deduction, and contains no indication that any such deduction is allowed to be made, for the benefit of any person whose income tax return is made out by some fiduciary.

It is true that "Instruction" No. 18 on the back of Form 1041 states that: "An unmarried individual or a married individual not living with wife or husband, shall be allowed an exemption of $3,000", and that "When husband and wife live together, they shall be allowed jointly a total exemption of only $4,000, on their aggregate income". But whoever constructed Form 1041, appears to have forgotten that part of the income tax law, for he omitted to so construct that form, as to enable anybody, when filling it out, to take advantage thereof.

The two forms of affidavit which are printed on the lower two-thirds of page 3 of Form 1041, were so unskillfully thrown together that neither of them can be used by any fiduciary, with any conscientious accuracy. For example, the first of those affidavits, would make the affiant swear that "the foregoing return" to the best of his knowledge and belief, contains a true and complete statement of all gains, profits and income coming into his custody and control and management, during the year for which the return is made; thus swearing that "the foregoing return" includes a true and complete statement of all his own gains, profits, and income, as well as a true and complete statement of all gains, profits and income coming into his custody or control and management, in his fiduciary capacity. When the writer of the two forms of affidavit came to write the second form, he happened to think of this point, and limited that form accordingly; but it appears that he did not also happen to think that the first of the two forms required the same limitation, and therefore did not go back and correct that form in that respect.

A proper and legal substitute for the first of the affidavits on page 3 of Form 1041 might run as follows:

I solemnly swear (or affirm) that the foregoing schedules, which are partly in print and partly in pen-writing or typewriting, constitute a true and accurate return, according to the best of my knowledge and belief, such as is required of me by the income tax law of the United States of America, which was approved October 3, 1913, relevant to the incomes of the beneficiaries whose names are stated in the first of those schedules; and that I was the duly authorized fiduciary, who had the custody or control and management of said incomes, during the last calendar year; and that said beneficiaries are entitled, as I am advised and believe, under the said income tax law, to all the exemptions and deductions entered in said return; and that all certificates claiming personal exemption, presented by any of said beneficiaries to me, are herewith enclosed; and that the said return contains a true and complete list of the names and addresses, as far as known to me, of all the beneficiaries to whom any part of the amount stated on line 3 of page 1 of said return, has been paid or is payable.

And a proper and legal substitute for the second of those affidavits, might be framed as follows:

I solemnly swear (or affirm) that I am the of the of which organization was the duly authorized fiduciary party, which during the last calendar year had the custody or control and management of certain incomes of certain beneficiaries, whose names are stated in the first of the foregoing schedules; and that those schedules, which are partly in print and partly in pen-writing or typewriting, constitute a true and accurate

return, according to the best of my knowledge and belief, such as is required of the said fiduciary organization, by the income tax law of the United States of America, which was approved October 3, 1913, relevant to the respective incomes of said beneficiaries; and that said beneficiaries are entitled, as I am advised and believe, under the said income tax law, to all the exemptions and reductions entered in said return; and that all certificates claiming personal exemption, presented by any of said beneficiaries, are herewith enclosed; and that the said return contains a true and complete list of the names and addresses, as far as known to me, of all the beneficiaries to whom any part of the amount stated in line 3 of page 1 of said return, has been paid or is payable.

Page 4 of Form 1041, is occupied by 19 Instructions which are furnished by the Commissioner of Internal Revenue, to tell fiduciary parties what statements to insert in the "Form" on pages 1, 2 and 3, and what statements to omit therefrom; and also what to do in some other respects.

Instruction No. 1, is wrong, in that it tells all fiduciaries to make and render the income tax returns for their beneficiaries, on Form 1041; which they cannot do without violating the income tax statute, as is proved by the statements on pages 50 to 56 inclusive of this pamphlet.

Instructions Nos. 10, 11, 12, 13 and 16, on the back of Form 1041, are respectively identical with Instructions Nos. 11, 12, 13, 14 and 17 on the back of Form

1040; and the criticisms on those Instructions which are printed on pages 41 to 49 inclusive of this pamphlet, are equally applicable to that set of five Instructions wherever they are printed.

Instructions Nos. 2 to 9, inclusive, and Instructions 14, 15, 17, 18 and 19, on the back of Form 1041, are tolerable; except the second paragraph of No. 8, which is not tolerable. But Form 1041, as a whole, when taken in connection with the code of nineteen "Instructions" on its back, cannot lawfully be used by any fiduciary; without those changes which are indicated as being necessary, on pages 51 to 56 of this pamphlet, and except in the light of those criticisms on those "Instructions" to which attention is called, on this page, and the one next before it.

SECTION 3.

Relevant to Corporations.

Form 1031 is devoted to banks and other financial institutions; Form 1032 is devoted to public service corporations, including railroad companies; Form 1033 is devoted to manufacturing corporations; Form 1034 is devoted to mercantile corporations; and Form 1035 is devoted to miscellaneous corporations. Each of these forms is printed on one side of a sheet of paper, ten and a half inches by sixteen inches in size. All five of these forms are exactly alike, except that the one devoted to banks and other financial institutions contains one item which none of the others contains, namely the item of interest paid on deposits.

Each of the five forms has two notes printed at its foot, namely Note A, and Note B. This set of notes is the same on Forms 1031, 1032 and 1035, and note B is the same on Form 1034. But note A on Form 1033 and note A on Form 1034 differ from each other, and each of them differs from note A on Forms 1031, 1032 and 1035; and note B on Form 1033 differs from each of the other notes B.

An elaborate code of twenty-three "Instructions" is printed on the back of each of the five forms, and is identical in each case, except that in Forms 1031 and 1032, the word "interest-bearing" in Instruction No. 15, is misprinted as "inter-bearing".

Inasmuch as these five forms are all so nearly identical with each other, and inasmuch as the codes of Instructions on their backs are quite identical with each

other; they can all be critically reviewed as one form, with proper collateral statements relevant to the foot notes, wherein there are some differences, and relevant to whatever differences may be detected, when the forms themselves are compared with the various provisions of the income tax statute which relate to them, respectively.

Form 1035 for miscellaneous corporations is therefore selected as the typical form to be reviewed and criticised. Everything to be mentioned in the course of this review and criticism, is equally applicable to each of the other four forms. And in the course of the statements to be made in that behalf, whatever collateral points which are peculiar to one or another of the other four forms, will also be attended to.

Form 1035, is simple enough in respect of the arrangement of its items, to be readily understood without explanation; but those items themselves require careful attention.

Items 1 and 2 are preliminary and are correct.

Item No. 3 is devoted to "Gross Income," and the taxpayer is directed, in a parenthetical passage in that item, to foot Note A and to Instructions Nos. 10, 17, 18 and 19, for guidance in respect of what sums are to be added together, to constitute that gross income. Note A, tells the taxpayer to include in that gross income, whatever interest it shall have received during the year covered by the return, upon the obligations of a State or political subdivision thereof, and upon the obligations of the United States or its possessions, *as shown by entries upon its books during the year for which the return is made.* The last sixteen italicised words of this require-

ment have no foundation in the statute or in reason; and if they were effective, they would enable any corporation receiving such interest, to omit its amount from its return of gross income, by simply omitting to enter its amount on its books. But aside from this point, a question arises relevant to the first clause of the last paragraph of subsection B, of the income tax statute, which clause provides "That in computing net income under this section, there shall be excluded the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States and its possessions."

It is true that sub-item b, of item 6 of Form 1035, provides that all such interest shall be included in the deductions which are to be made from the gross income, which according to Note A, must include all such interest. Therefore, the net taxable income to be entered as item No. 8, will be the same when Form 1035 is followed, that it would be, if the interest in question were to be omitted from the gross income on the one hand, and also omitted from the deductions on the other hand. But a corporation receiving such interest may have a legitimate preference for not mentioning it and including it in its income tax return on either side of the account, instead of including it on both sides of the account. It seems probable that it was the existence of this legitimate preference, which caused Congress to provide in the language last quoted from the statute, that the interest in question shall be excluded from the computation altogether, instead of providing that it should be first included in gross income and afterward deducted therefrom when computing net income.

Instruction No. 10, on the back of Form 1035, is wrong in providing that the gross income of a corporation for a particular year, shall include "all actual increases in value, by appraisement, adjustment or otherwise, in the value of the assets which have been taken up on the books as income, or credited to profit and loss during the year." There is no foundation in the statute for this Instruction. Its only known foundation is in four paragraphs beginning with line 8 from the bottom of page 37, and ending with line 7 from the top of page 39, of a pamphlet which was written by Luther F. Speer, before the income tax law was approved by the President, and even before it was passed by Congress. That pamphlet, having been thus written, was printed soon enough to be published and widely distributed, on the third or fourth day after the evening on which the income tax law was signed by President Wilson. And on the first or second day after the publication of the pamphlet, its author, who had for twenty years been a clerk in the Treasury Department, was appointed by the Commissioner of Internal Revenue, to be the deputy commissioner, to have charge of administering the income tax law.

The Walker pamphlet which is entitled, "The Income Tax Law of the United States of America, Analyzed and Clarified", was published a few weeks later than the Speer pamphlet, and has since been purchased in large numbers by citizens residing in all parts of the United States. That pamphlet contains, between its text and its appendix, an "Insertion" of pages 62 to 74, which is entitled "A Criticism of the Speer Pamphlet", and which points out and elaborately establishes the

existence of fourteen important errors therein. The fourteenth of those errors is the one now under consideration.

The original promulgation of that error by Mr. Speer in his pamphlet was argumentative only, and did not contain any assertion of any express statutory foundation for the opinion of Mr. Speer. His argument began as follows: "Income from increased property values is a question which has heretofore given rise to considerable discussion, as to whether or not an increase in property value actually constitutes income. There is much of merit on both sides of the discussion. However, for the purposes of the income tax, such increases would appear to be properly returnable as income for the following reasons. First, the law provides that accrued income shall be reported: Second, an allowance for depreciation of property is made".

The first of these "reasons" is destitute of foundation; for the gross income of a person or corporation, according to the statute, does not include anything but income "derived" or "received", and because according to the statute, the net income of a person or corporation includes nothing not included in the gross income thereof.

The second of Mr. Speer's "reasons" is also destitute of foundation; for the depreciation of property which is allowed for by the statute, is expressly confined to physical depreciation, due to depletion or exhaustion, or to wear and tear arising out of the use or employment of property. There is no analogy, by way of contrast or otherwise, between the statutory allowance for *physical* depreciation of property, and Mr. Speer's proposition to charge the owner of property with every

increase in the *market* value of property; and the statute does not allow any deduction from gross income, on account of any depreciation in *market* value of anything.

The argument against Mr. Speer's error on this subject is fully developed on pages 72, 73 and 74 of the above mentioned Walker pamphlet on the income tax law; where the fourteenth error in Mr. Speer's pamphlet is attended to and refuted. But it now appears that Mr. Speer, in his official capacity as deputy commissioner of Internal Revenue, charged with the administration of the income tax law, is seeking to enforce that error upon all income tax payers, as if it were a part of the income tax statute; instead of being, as Mr. Speer in the Speer pamphlet showed it to be, only his own argumentative opinion of what an income tax statute ought to provide.

Item No. 3 in Form 1035 not only refers the taxpaying corporation to Instruction No. 10, on the back of that form, but likewise points to Instructions Nos. 17, 18 and 19 as proper guides for such a corporation. Instruction No. 17 is quite correct. Whether Instruction No. 18 is correct or not, depends upon the hereinabove discussed question, whether the interest received upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions, should be included among the items of gross income, and afterward deducted from gross income, by being included among the items of deducted income; or whether such interest should be omitted from both sides of an income return.

Instruction No. 19 is as follows: "Accrued interest is considered to be interest due and payable, except in the case of banking or other similar institutions, which close their accounts on the basis of the interest earned. In all cases the accrued interest shall be reported on the basis on which the books are closed".

This Instruction appears on its face to refer to interest *paid* by a corporation as well as to interest *received* by a corporation. The question whether any item of interest should include interest earned but not accrued and not paid, or should be confined to interest earned and accrued, if paid or not, or should be confined to interest earned, accrued and paid, is a question which ought to be answered in the same way, in respect of both sides of the interest account of a corporation. But Form 1035, when analyzed in connection with this Instruction No. 19 on its back, requires a taxpaying corporation to include in its gross income all accrued interest whether paid or not, and sometimes to include all earned interest whether accrued or not. But where, in subitem a, of item 6 of Form 1035, provision is made for the other side of the interest account of a corporation, the instruction is to include therein only some interest which has accrued and has also been paid by that corporation. The statute itself is not chargeable with this inconsistency, for it expressly provides that in making up their income returns, corporations are to be credited with no interest not accrued and also paid by them; and the statute does not provide that such a corporation is to be debited with any interest not accrued and paid to it.

The idea of the Commissioner of Internal Revenue

to the contrary of the last statement, has no even apparent foundation in the statute, except a misunderstanding of the first clause of subdivision a, of subsection G of the income tax statute. That clause provides "That the normal tax hereinbefore imposed upon individuals, shall likewise be levied, assessed and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation". The Commissioner of Internal Revenue apparently thinks that the word "accruing" in this passage, refers to the accumulation of a gross income, and therefore means that a gross income includes money accrued as well as money received. But it expressly appears in the passage that the word "accruing" therein, applies only to the process by means of which a net income is deduced from a gross income. In this place, as in other places in the statute, a net income is said to accrue from a gross income. But the statute nowhere expresses or implies the idea that any gross income includes anything which has not been actually received.

Attention may now be given to item 3, on Form 1034, for mercantile corporations; for it points to one "Instruction" in addition to those pointed at in item 3 of Form 1035, and that is the following.

Instruction No. 21, on the back of Form 1034, runs as follows: "The gross income of mercantile corporations should be ascertained in the following manner: From the sum of the total sales during the year, plus the sum of the inventory at the end of the year; deduct the sum of the inventory at the beginning of the year, plus the cost of goods and materials purchased during the year; *to this difference add the income received from*

any other source, and the result will be the gross income to be reported under Item No. 3 of the return".

This instruction is well enough as advice, except that it is erroneous in the use of the eleven words which are italicized above. Because no income taxpayer is required to include, in a return of gross income, *all* the income received from *every* source. For example, a mercantile corporation may properly take out a life insurance policy for its own benefit, upon the life of one of its officers or employees, to guard against such a pecuniary loss as might result from the death of such a man. If afterward, the dreaded and injurious death does occur, the mercantile corporation is entitled to receive the proceeds of such a life insurance policy; and the last sentence of the first paragraph of subsection B, of the income tax statute, expressly provides that the proceeds of life insurance policies, paid upon the death of the person insured, shall not be included as income to be taxed against the party receiving those proceeds.

Form No. 1033 for manufacturing corporations, differs from Form No. 1034, in respect of its item No. 3, in that, instead of pointing to Instruction No. 21, as necessary to be followed, it points to Instructions Nos. 22 and 23 in that behalf. Those Instructions are substantially one Instruction, which reads as follows:

"Gross income in the case of a manufacturing corporation, shall include the total receipts from the sale of all manufactured goods sold during the year, plus any increase in the inventoried value, ascertained through an accounting of the finished and unfinished product, raw material, etc., on hand at the close of the year. To the income thus ascertained, there should be added the income arising, accruing or received from any and all

other sources, the aggregate thus ascertained to be the gross income to be returned under Item No. 3 of the return form. Since the gross income thus ascertained represents the total receipts as well as the inventoried value of finished and unfinished products, raw material, etc., the corporation will include in its deduction under Item No. 4, all expenditures for material, labor, fuel, and other items going to make up the cost of the goods sold or inventoried at the end of the year."

This complicated double Instruction is erroneous, in that it requires the inclusion in gross income of whatever *accrues* without being *received;* and in that it also requires the inclusion in gross income of all that is received, *from all sources whatever.* In this case as in other cases already explained in this pamphlet, the statute does not contain any such, or any similar direction to include in any gross income everything which has merely *accrued* without being *received.* Also in this case, as in other cases already discussed and explained, the statute does not require every taxpayer to include in his return of gross income, everything received from all sources. For the first paragraph of subsection B, of the statute, expressly provides that certain incomes received from certain sources therein specified, shall not be included as income.

This complicated Instruction also has an error peculiar to itself, in that it ignores the fact that the inventoried value of the property of a manufacturing corporation, may be less at the end of a year, than it was at the beginning of that year. And ignoring that obvious fact, this Instruction tells the taxpayers to include in their respective gross incomes whatever *increase* in the inventoried value of their respective properties may

occur in a particular year; without giving any of those taxpayers any instruction or any opportunity to deduct anything from such gross income, on account of any *decrease* in any such inventoried value during any year.

It is now in order to explain the foot notes A and B, on the faces of the Forms 1031 to 1035, inclusive.

Note A, at the foot of the face of Form 1033, for manufacturing corporations, tells such a corporation how to calculate its gross income, and thus attends to the same subject that is attended to in Instruction 22, and in the first sentence of Instruction 23, on the back of Form 1033. But that note is less erroneous than those Instructions, in that it provides for the possibility that the amount and value of property in a factory may decrease, instead of increasing, during a year. But Note A is equally erroneous with Instruction 23, in respect that it tells the taxpayer to include in his gross income, all income derived from any and all sources; in face of the fact that the first paragraph of subsection B of the statute provides, in respect of several kinds of income, which may be received by a manufacturing corporation, that they shall not be included as income.

Note A at the foot of the face of Form No. 1034, for mercantile corporations, attends to the same subject as that of Instruction No. 21 on the back of that form. But it is inconsistent with that Instruction, and also inconsistent with reason, in that it *charges* the item of gross income with the sum of the inventory at the beginning of the year, and *credits* that item with the sum of the inventory at the end of the year, which is opposite to what it ought to do, and opposite to what Instruction 21, directs to be done.

Note A, on the faces of Forms 1031, 1032 and 1035, is the same in each of those three cases, and it is erroneous in each case, in that it calls upon the corporation making the return, to include in its gross income, all amounts of income from all sources; in face of the fact that income from some sources, according to the first paragraph of subsection B of the income tax statute, should not be included as income under that statute.

Note B, at the foot of Forms 1031, 1032, 1034 and 1035, is the same in each case, and reads as follows: "The deductions authorized shall include all expense items under the various heads, acknowledged as liabilities by the corporation making the return and entered upon its books during the year. Amounts of income expended in paying dividends on stock, preferred or common, or in making permanent improvements or betterments, etc., or in any way transferred to capital account, should not be deducted in ascertaining annual net income. Interest paid on mortgage indebtedness, on real estate occupied or used by a corporation, may be deducted under Item 4, if the interest is paid as a rental or franchise charge, payment of which is required to be made as a condition to the continued use and possession of the property. The amount so paid and included in Item 4, should be stated separately under Item 4 (b). (See paragraph 12 on reverse of this form.)"

This Note B; and also Instruction 12, which is referred to at its end, are both substantially correct, unless there is an important difference between the phrase "use and possession" in Note B, and the phrase "use or possession" in Instruction No. 12. The statutory phrase is "use or possession", as appears in the upper part of subdivision b of subsection G of the statute.

Note B, at the foot of the face of Form 1033, for manufacturing corporations, and Note A, at the foot of the same Form, when those two notes are considered together, cover about the same ground, that is attended to in Instructions 22 and 23 on the back of the same form. Those two sets of attempted guidances, to the same objective points, differ considerably from each other in expression, and differ to some extent in substance. And both of them are wrong, in requiring the manufacturing corporation making the return upon Form 1033, to include in its gross income, such items as those specified in the first paragraph of subsection B of the statute as not proper to be thus included.

DEDUCTIONS are provided for in items 4, 5, 6 and 7, in Forms 1031, 1032, 1033, 1034 and 1035 respectively.

Sub-item a, of item 4, reads as follows, in each of the five forms: "Total amount of all the ordinary and necessary expenses paid within the year, in the maintenance and operation of the business and property of the corporation, exclusive of interest payments." This direction is proper to be followed when filling out any of the five forms above specified. The quoted language is also accompanied by the suffix (See Note B) in each of the forms and Note B calls attention to Instruction 12, on the back of each form for further directions. That note and that Instruction are proper to be followed in each case, though there is a mild discord between Instruction 12 and Note B, on Forms 1031, 1032, 1034 and 1035.

The suffix to sub-item a, in item 4, includes not only the direction to "See Note B," but also the direction

to see Instruction 23, on the back of that form. It is only the last sentence of Instruction 23 that is relevant to sub-item a, of item 4; but that relevancy is proper to be regarded and followed.

Sub-item b, of item 4, is properly expressed in all five of the forms, and its suffix pointing to Instruction 12, on the back of each form, is also proper.

Sub-item a, of item 5, is the same in each of the five forms, and is correct in each case.

Sub-item b, of item 5, is the same in each form, except that Forms 1032, 1033 and 1035 direct attention to Instructions 13 and 14 on their backs; whereas no such direction is expressed in Form 1031, or 1034. But those Instructions are applicable to those two forms as truly, though not as extensively, as to the other three.

There is a difference of general application between those Instructions 13 and 14, and the statute which they purport to represent. That difference consists in the fact that those Instructions inform every tax paying corporation that its deduction on account of depreciation of property, includes depreciation on account of "obsolescence" of buildings, machinery, and any other property. There is no foundation in the statute for any such deduction. It is a case of attempted law making by the Commissioner of Internal Revenue, and is apt to be availed of to defraud the Government, by means of deductions based on fictitious "obsolescence" of property, which will recover from that disease very soon after March 1 of each year. The approach of the vernal equinox, and the ascension of sap in the trees, will be likely to cure many cases of "obsolescence" in machinery every Spring.

This sub-item b, of item 5, in each form, even as explained in Instructions 13 and 14 on their respective backs is wrong in not telling any corporation, owning a mine, that its deduction for depreciation thereof, must not exceed 5 per cent of the gross value of the output of that mine, for the year for which the computation is made, though that is the law established for all corporations by the statute in the second paragraph of its subsection G.

The Form 1040, prescribed for individual taxpayers, and the Form 1041, prescribed for fiduciaries, sets forth this law as applicable to them; but the Commissioner of Internal Revenue gives all corporations to understand that it is not applicable in any of their cases. According to the Commissioner of Internal Revenue, the Philadelphia and Reading Coal and Iron Company is not limited, in the amount of the deduction it may make from its gross income, on account of depreciation of value of any of its coal mines; whereas John C. Haddock, an independent coal miner, is limited in that respect, to 5% of the annual output of each of his mines, respectively. But the income tax statute is not guilty of that discrimination in favor of the corporation, and against the man. It treats them alike. It thus treats the man, in the second paragraph of subsection B, and it thus treats the corporation in the second paragraph of subsection G.

Sub-item a, of item 6, is the same in each of the five Forms 1031, 1032, 1033, 1034 and 1035; and is correct in all of them.

Sub-item b, of item 6, of Forms 1032, 1033, 1034 and 1035, is alike in each of those four forms, and is also like sub-item c, in Form 1031. It is also correct, if the interest moneys covered thereby are to be included in the gross income, but not otherwise.

Sub-item b, of item 6, Form 1031, for Banks and other financial institutions, is wrong in confining the deduction to which it refers, to interest paid on deposits, for the statute extends that deduction to also cover interest paid on money received for investment, and secured by interest-bearing certificates of indebtedness; as the Commissioner would have seen if he had read the second and third paragraphs of subsection G, of the statute.

Item 7, in Forms 1031, 1032, 1033, 1034 and 1035 is uniform in all, and it agrees with the statute upon a point wherein the statute is undeniably wrong. That point consists in the fact that "assessments for local benefits" are not excluded from deductable taxes in the case of any corporation, though they are in the case of every individual. The error of the statute on this point results from the plain difference between the second paragraph of its subsection B, as to persons, and the second paragraph of its subsection G, as to corporations.

Another discrimination in favor of corporations against persons resides in the fact that, according to sub-item b, of item 7, in each of the Forms 1031, 1032, 1033, 1034 and 1035, corporations deduct from their gross incomes whatever taxes they may have paid in Canada, or any other foreign country; which is a thing no individual is permitted by the statute to do, or is told in Form 1040, or 1041, that he may even attempt.

The form of affidavit on Forms 1031, 1032, 1033, 1034 and 1035 is alike in all five cases. Any officer of any corporation who makes out an income tax report on one of those forms, in conformity with the statute, and without helping to extort money from his corporation, runs

a considerable risk of committing perjury, if he signs and swears to one of those affidavits. To avoid this danger and still do his full duty, he may cancel from the blank affidavit the following words, namely: "that the amount of gross income therein set forth, is the full amount of gross income, without any deduction whatsoever, received from all sources by said corporation, during the year stated" and he may add to the affidavit the following words, namely: "for the year to which the said annual return refers."

The back of each of the Forms, 1031, 1032, 1033, 1034 and 1035 is occupied by a code of 23 "Instructions." Those numbered 10, 12, 13, 14, 17, 18, 19, 21, 22 and 23 have already been subjects of comment in this section of this pamphlet. Those numbered 1, 2, 3, 4, 6, 7, 8 and 16 are correct, and require no comment. Those numbered 5, 9, 11, 15 and 20 remain to be examined.

Instruction No. 5 is wrong in telling the tax paying corporation that its return "must disclose all the income arising, accruing or received from all sources during the year for which the return is made." For no corporation is required by the statute to disclose any income which merely *arose* or *accrued;* and there are some classes of income which may be *received* by a corporation which the statute does not require it to disclose. Some previous pages in this pamphlet are devoted to those exemptions from disclosure.

Instruction No. 9 is wrong in saying that "In the case of banking corporations, and like financial institutions, deposits should not be reported as indebtedness."

The statute makes no such exception from its requirement that every corporation shall state in its return, the total amount of its bonded and other indebtedness at the close of the year.

Instruction No. 11 is wrong in limiting the required report of expenses to those "paid out of earnings." The statute allows all ordinary and necessary expenses to be deducted from gross income, whether those expenses are paid out of earnings, or out of capital, or out of borrowed money.

Instruction No. 15 is correct, as far down from its beginning as the word "year" in the sixth line. From that word, down to and including the words "United States," eight lines below, the language of this Instruction is a copy of a fragment of the third paragraph of subsection G of that statute. That fragment of the statute is the only part of it which absolutely defies analysis and clarification. It probably has no coherent meaning; or if it has, that meaning is hidden so deep in its muddy verbiage that it will probably never be fished out.

Instruction No. 20 is right in telling every corporation that its legal deduction from gross income, on account of taxes, does not include those vicariously paid by it on the interest due to its bond holders on its bonds, in pursuance of its "tax free" guaranty. But that instruction is wrong in saying that said deduction does not include taxes assessed against local benefits. The statutory law on the first of these points is expressed in the first clause of the fourth proviso of the second paragraph of subsection G of the statute; and the law on the last of these points is expressed in the first language

which follows that proviso, and begins with the word "fourth," and ends with the word "country" immediately before the fifth proviso of the second paragraph of subsection G.

INSURANCE COMPANIES are required by the Commissioner of Internal Revenue to render their income tax returns upon Form 1030. That Form has a general appearance much like Forms 1031, 1032, 1033, 1034 and 1035; but it differs from that set of Forms in so many particulars that it requires separate treatment. It is simple enough to be readily understood with respect to the arrangement of its items; but those items themselves require some detailed attention.

Item 1 is correct, as also is Instruction No. 8, on the back of the sheet, to which item 1 calls attention.

Item 2 is correct. It calls attention to Instruction No. 9, on the back of the sheet. That Instruction has two points, stated in two separate sentences. The first of those sentences refers to insurance companies, and is correct. The second of those sentences refers to banking corporations and like financial institutions, and is incorrect as to them, for reasons stated in the preceding part of this pamphlet relevant to Form 1031.

Item 3 in Form 1030 covers gross income. It calls attention to Note A, at the foot of the Form, and also to Instructions Nos. 10, 18, 21, 22, 23, 25 and 26, on the back of the Form.

Note A is complicated, but is correct in all respects, except that its words "together with all amounts of income from other sources," are much too broad. They cover a number of sources of income from which an insurance company may receive moneys, and which moneys, if thus received, are exempted by the income tax statute from mention in any income tax return. Such are the proceeds of life insurance policies paid upon the death of the person insured, and such also are whatever

amounts may be received by an insurance company, as interest upon the bonds or other obligations of a State or any political subdivision thereof, or of the United States or any of its possessions.

Mr. Speer, the Deputy Commissioner of Internal Revenue, when he published his pamphlet early in October, 1913, took the ground that any corporation which receives any such interest money, is subjected by the income tax statute, to an income tax of one per cent upon that interest. That was the first of the fourteen errors in the Speer pamphlet, which were disclosed to the public on pages 62 to 74, of the Walker pamphlet of October, 1913, on the income tax law. The refutation of that error, which was printed on pages 63 and 64 of that pamphlet, was so undeniable, that Mr. Speer abandoned that ground, when he construed Form 1030, for insurance companies. But in order to "save his face" as much as he could appear to do, he still takes the ground, in his Form 1030, that such interest must be included in the gross income of an insurance company, though he is now compelled to provide for its subsequent deduction therefrom, in sub-item b of item 6 of Form 1030.

But Mr. Speer, acting as Deputy Commissioner of Internal Revenue, still ignores the undeniable fact that an insurance company may properly take out a life insurance policy on the life of any of its officers or employes, in order to guard as far as possible against whatever loss might result, to such an insurance company, from the premature death of the person insured for its benefit. And he also ignores the fact that the income tax statute expressly provides, in the last sentence of the first paragraph of subsection B, that the proceeds of such a life insurance policy, when paid upon the death of the person insured, to the person or corporation for whose benefit the policy was issued, shall not be included as income of that beneficiary, in the eye of the income tax

law. And as Deputy Commissioner of Internal Revenue, Mr. Speer not only insists that the proceeds of any such life insurance policy shall be included in the gross income of life insurance companies, but also he does not provide that those proceeds shall be included in any deduction from such gross income. Therefore, his error relevant to such proceeds of any life insurance policy is not only an error of form, but is also an error of substance.

Instruction No. 10, which the Commissioner of Internal Revenue directs to be followed in calculating gross income in Form 1030, is identical with Instruction No. 10, which he directs to be followed in calculating gross income in Forms 1031, 1032, 1033, 1034 and 1035; and that instruction is erroneous in respect of Form 1030, for the same reasons which make it erroneous in respect of those five Forms. Those reasons are stated and explained on pages 61, 62, and 63, of this pamphlet.

Instruction No. 18, to which the Commissioner calls attention in connection with item 3, in Form 1030, is really erroneous in requiring insurance companies to include in gross income whatever interest they may have received upon the obligations of a state or any political subdivision thereof, or upon the obligations of the United States or its possessions; although sub-item b, of item 6, of the same Form, provides for including the amount of such interest among the deductions from gross income. There is no warrant in the law for compelling any insurance company to laboriously and expensively calculate and add together all the items of interest which it may have received during a whole year, on all those obligations, for no other reason than to first add their amount to the debit side of their income tax account, and then deduct the very same amount from the credit side of that account. Moreover, the Commissioner of Internal Revenue has no right to compel any person or any

corporation to disclose, in its income tax return, either the existence or the amount of any class of money which the income tax statute expressly exempts from income taxation.

Instruction No. 21, to which attention is called in connection with the item of gross income in Form 1030, does not refer to mutual marine insurance companies, for those companies are expressly excepted therefrom. As to other insurance companies, that Instruction is correct, unless it contains some hidden meaning which is not visible on its surface.

Instruction No. 22 refers only to mutual fire insurance companies, and it is correct.

Instruction No. 23 refers only to mutual marine insurance companies, and it is correct, except in referring to Instruction No. 21, which is not relevant thereto.

Instruction No. 25 refers only to life insurance companies, and as to them it is correct.

Instruction No. 26 refers only to mutual fire insurance companies, and as to them it is correct.

The deductions from gross income which may be made by insurance companies when computing net taxable income, are attended to in items Nos. 4, 5, 6 and 7 of Form 1030; item No. 4 comprising sub-items a and b; and item No. 5 comprising sub-items a, b, c, d and e; and item No. 6 comprising sub-items a and b; and item No. 7 comprising sub-items a and b.

Sub-item a, of item No. 4, is correct in itself, and is also correct in referring to Note B at the foot of Form 1030; and that note is correct in itself, and also in referring to Instruction No. 12, on the back of Form 1030.

Sub-item b, of item No. 4, is correct in itself, and is also correct in referring to Instruction No. 12.

Sub-item a, of item 5 is correct.

Sub-item b, of item 5, is correct, except in referring to Instruction No. 13 for guidance; and it is correct in

that respect also, except in thereby appearing to authorize the corporation making the return, to include under the head of "depreciation" such depreciation of property as results, or may be claimed to result, from "obsolescence." There is no authority in the statute for calculating depreciation of property upon the basis of any "obsolescence."

Sub-item c, of item 5, conforms literally to the statute in providing that any insurance company is entitled to a deduction from its gross income of "the sums, other than dividends, paid within the year on policy and annuity contracts." But the statute does not state whether this word "dividends" includes those so called "dividends" of insurance companies, which are not paid in cash, but which are really unearned portions of previously paid premiums which are credited to policy-holders on the books of insurance companies, as against premiums to subsequently accrue. Officers and attorneys of insurance companies are apt to contend that the word "dividends" in this part of the statute does not include those so called dividends thus credited, and that therefore the amounts of those so called dividends may properly be deducted from their gross incomes, when calculating their net taxable incomes. On this point, those officers and attorneys are probably right.

Sub-item d, of item 5, requires to be corrected by changing its word "fund" to the plural number of the same noun. When thus corrected, that sub-item is right in itself, and is also right in referring to Instruction, No. 28, which Instruction is correct in all respects.

Sub-item e, of item 5, is applicable only to mutual marine insurance companies, and though it does not literally conform to the statute, it does so substantially.

Sub-item a, of item 6, is correct as applied to insurance companies having capital stock; but as applied to insurance companies having no capital stock, it requires

to be amended by adding the words "or if no capital stock, the amount of interest paid within the year, on an amount of its indebtedness not exceeding the amount of capital employed in the business, at the close of the year."

Sub-item b, of item 6, is correct if the amounts of interest covered thereby are also included in the gross income covered by item 3. Properly and legally that amount should be excluded from item 3, and therefore not deducted from gross income, as sub-item b, of item 6. But if that amount is to be put into gross income under item 3, it ought to be afterward deducted therefrom, as Form 1030 proposes to deduct it.

Sub-item a, of item 7, is correct in itself, and is also correct in referring to Instruction No. 20, except that Instruction No. 20 is out of conformity with the statute, in telling insurance companies that they are not entitled to include in deducted taxes those which are assessed against local benefits. That is not true in the case of any insurance company or any other corporation; though it is true in the case of every natural person.

Sub-item b, of item 7, conforms to the statute in allowing an insurance company to include in its deductions from gross income, whatever taxes it may have paid in Canada or Cuba or any other foreign country, which is a favor denied by the statute to all natural persons.

Item 8, of Form 1030, is the net taxable income on which the normal tax is calculated, and that amount is arrived at in Form 1030, by adding together all the deductions which are properly inserted in their proper places in the Form, and thereupon subtracting their aggregate amount, from the amount of the gross income inserted in item No. 3.

The blank affidavit which is printed on the face of Form 1030, can not properly be used, for it purports to require the affiants to swear to several points, which will not be true if the Form is to be filled out in accordance with the statute. Before signing or swearing to that blank affidavit, any officer of any insurance company should carefully draw a pen through those of its words which begin with the word "that," immediately after the word "particular," and which end with the words "during the year stated" immediately after the word "corporation". And having cancelled those words, an affiant should add the words "for the year covered by the said return" to the present end of the affidavit.

A code of "Instructions" which are twenty-eight in number, are printed on the back of Form 1030, for the guidance of insurance companies, when making out their income tax returns upon that form. Those instructions which are numbered 8, 9, 10, 12, 13, 20, 21, 22, 23, 25, 26 and 28, have already been commented upon, in the course of the foregoing explanation and criticism of Form 1030, itself. Those instructions which are numbered 2, 3, 5, 6, 7, 14, 16, 17, 24 and 27 are correct and are self-explanatory. This leaves instructions Nos. 1, 4, 11, 15, 18 and 19 for consideration now.

Instruction No. 1 reads as follows: "Return of annual net income of corporation should be made on forms prescribed by the Treasury Department, and should be filed with the Collector of Internal Revenue of the district in which such corporations have their principal places of business." This instruction is correct *as it reads*, but if any Collector of Internal Revenue were to insist that every return to be made on any Form thus prescribed, must be made in literal accordance with the directions printed on the face of the Form, or in literal obedience to the "Instructions" printed on its back,

that Collector would be doing wrong. For any person who would thus follow those directions and those instructions, would be violating the income tax statute; and if he were then to swear to the report thus made out by him, he would be swearing erroneously.

Instruction No. 4 reads as follows: "Under the provisions of the law, the return must be true and accurate in every respect, and must disclose all the income arising, accruing or received from all sources, during the year for which the return is made." This Instruction is contrary to the statute, in that it demands a disclosure of all income *arising* or *accruing,* though not *received,* which is a disclosure which the statute does not require. And this Instruction also violates the statute in requiring a disclosure of *all* the income *received* from all *sources;* whereas the statute expressly exempts from such disclosure, all property acquired by gift, bequest, devise or descent; and also the proceeds of all life insurance policies, paid upon the death of the person or persons insured; and also all payments made or credited to any person, on any life insurance, endowment or annuity contract, at the maturity of the term mentioned in such contract, or upon the surrender thereof; and also all interest received upon any obligation of any State or any political subdivision thereof, or upon any obligation of the United States or upon any of its possessions.

Instruction No. 15 is correct from its beginning down to the semi-colon which follows the word "year" in its sixth line. That portion of that instruction which follows that semi-colon, and continues to the period which follows the words "United States" eight lines below, is a copy of a fragment of subdivision c, of subsection G, of the statute. That fragment refers only to income tax returns, to be made by foreign corporations, and refers only to one point in such a return. These are all the facts that are known about that frag-

ment, for its significance on the subject to which it refers is unknown, and past finding out. Probably its ambiguous language arose from some error of some typewriter girl, made when trying to copy some other paper, and whose work was never reviewed by any statesman, but was simply inserted in the statute as it came from her, without being considered by any other intellect.

This pamphlet has thus reviewed and criticised, in minute detail, the eight "Forms" which have been prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to be used by persons, fiduciaries and corporations, when making up their "true and accurate" income tax returns, under oath or affirmation. Those eight "Forms" are all that have been thus prescribed, and they are all that are called for by the statute; or rather they would be all, if they were all correct.

PART THREE.

RECOMMENDED REMEDIES.

FIRST.—The President may remove Commissioner of Internal Revenue Osborn from the office which he holds, and may nominate, and with the advice and consent of the Senate, may appoint some other man to that office who can, without self-stultification, reverse, in some cases, and amend in other cases, such of the "Regulations" or "Instructions" as the Commissioner has made and is trying to enforce, without any authority of law, and contrary, in many cases, to the income tax statute itself. And the President can select for that difficult work and great responsibility, some man who has large legal knowledge and executive ability, and who is willing and able to himself superintend the business of the office.

SECOND.—Congress may pass and the President may sign in February, 1914, a bill which can be properly written in a day, and made into law in a week, for the purpose and with the effect of amending the income tax statute of October 3, 1913, so as to cure those of its errors which are undeniable, and for the purpose and with the effect of directing the Commissioner of Internal Revenue to reverse those of his "Regulations" and those of his "Instructions," which are arbitrary and unjust, and inconsistent with the intention of Congress. Among those errors in the statute itself, which might thus be corrected, is that one which, if uncorrected, will compel many citizens of Ohio and other states to practically pay income taxes upon the property they lost in the floods of the spring of 1913. Among those "Regulations" of the Commissioner of Internal Revenue, which he can be caused by such an amendment to reverse, is that of October 25, 1913, in which he undertook to discriminate against citizens of the United States, and in favor of

non-resident aliens, in respect of levying income taxes upon the interest received by them in the United States on precisely the same classes of bonds, of corporations, earning in the United States all the money used in paying any of that interest.

THIRD.—Congress, during its present session, may pass, and the President may sign, a bill providing for the appointment by the President, of a commission of a few able lawyers, for the special purpose of preparing for the use of Congress, a draft of a proper bill for a constitutional income tax law; and that bill might be drawn by that commission within a few weeks, and afterwards introduced into the House of Representatives by some member, and thereupon be enacted into law as thus drawn, before the end of 1914, to take the place of the income tax statute of 1913. This recommendation may be unpleasant to some members of Congress and some Senators; because they will feel that it assumes that those personages are not competent, without assistance, to frame all the statutes which they enact, and do all the mental labor which is involved in per forming all their governmental functions. But the feelings of those gentlemen ought to be somewhat soothed, by the fact that the old country, from which we have drawn the foundation of our laws, long ago incorporated into her own customs, several proper plans for furnishing professional assistance to members of Parliament. Thus, the historic *judicial* functions of the House of Lords, are no longer performed by the hereditary noblemen themselves, but are performed by "law lords", who are appointed to sit in the House, for the express purpose of doing its judicial work. Thus also, the im-

portant *legislation* of the two houses of Parliament, is framed by non-official experts, who are employed by the ministry, to draw the bills which the ministry decides to introduce and to advocate. For these reasons, and for others quite honorable, it results that no insult to Congress is involved or implied in the present suggestion.

FOURTH.—That permanent unconstitutionality of the income tax statute, which results from "the deduction and payment of the tax at the source of income," can be made the subject of a prompt decision of the Supreme Court of the United States, by the following procedure: Any stockholder of any corporation, organized and operating in the United States, any of whose officers or employees served that corporation through the year 1913, at a fixed or determinable compensation of more than $3,000, may file a bill in equity against that corporation, in the United States District Court, for any district wherein it may legally be sued; and that stockholder may file that bill on behalf of himself, and of all other stockholders of that corporation who are similarly situated.

That bill in equity may state that the defendant is a corporation, organized and existing according to law in a particular State, and that the named complainant is a stockholder of that corporation; and that said corporation has one or more officers or employees, or both, who served it through the year 1913, at fixed or determinable compensations of more than $3,000 each; and that the said corporation intends to conform to the United States income tax law of October 3, 1913, by expending its own money, in the business of collecting, at its own risk and without any compensation, certain income taxes which, according to that statute, appear to be due from

those officers and employees respectively, to the United States; and that those provisions of that statute which impose upon the defendant corporation the cost and the risk which will be caused by its performance of that collecting business, are void in that they are violative of the Fifth Amendment of the Constitution of the United States.

And that bill of equity may pray that a writ of injunction shall be issued by the District Court, restraining the defendant corporation, and all its officers and other agents, from undertaking or conducting, any such collecting business, and also from withholding, from any of its officers or employees, and turning over to any officer of the United States Government, any portion of any such compensation, earned by them respectively during the year 1913.

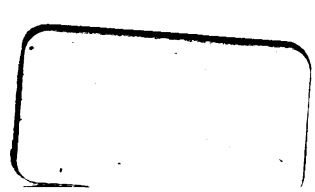
Such a bill in equity being filed, it can most properly be met, under the new equity rules, by a motion to dismiss the bill, and which motion will have the same effect that a demurrer would have had under the old equity rules. Such a motion to dismiss will assume the truth of all the statements contained in the bill; and on the hearing of that motion, the judge holding the District Court may enter an order sustaining it, on the ground that he will not take the responsibility of holding a statute of the United States to be void, as violative of the Constitution of the United States, and must therefore hold the income tax statute to be valid, and so holding, must dismiss the bill.

From that decision, the complainant can immediately appeal to the Supreme Court of the United States, in pursuance of Section 238, of the Judicial Code of March 3, 1911, and thereupon the Supreme Court may, in pursuance of its own rules, advance the case, and hear it and decide it almost immediately.

This is substantially the same procedure as that by means of which the question of the constitutionality of the income tax law of August, 1894, was taken through the United States Circuit Court for the Southern District of New York, to the United States Supreme Court, and argued there in March, 1895, and partly decided by that tribunal in April, 1895, and finally decided there, against the validity of that statute, on May 20, 1895; which was less than nine months after that law was proclaimed by the Secretary of State. At the same rate of progress, the question of the permanent unconstitutionality of the income tax law of October, 1913, can be decided by the Supreme Court of the United States, prior to its adjournment early in June, 1914, and thus prior to the last day allowed by the income tax law for the payment of income taxes for the year 1913.

FIFTH.—The inoperativeness of the income tax statute, upon the year 1913, can also be made the subject of a prompt decision of the United States Supreme Court, by proceedings begun with a bill in equity, filed by one of its stockholders, against any corporation organized and operating in the United States, which intends to pay an income tax, in accordance with that statute, upon any income which it received during that year. Those proceedings can be similar to those which are outlined, as the Fourth remedy, and if properly conducted, they may be expected to be successful.

ALBERT H. WALKER.

PARK ROW BUILDING,
MANHATTAN, NEW YORK,
February 4, 1914.

Ex. 1105
3/[illegible]